CAP ANALYSIS

RETRANSMISSION CONSENT AND CABLE TELEVISION PRICES

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Contents

I. Introduction 1

II. Programming Costs Are Not Driving Increases in Cable Rates 2

A. Quality Adjusted Cable Rates Are Not Rising Rapidly 3

B. Programming Costs Are Not Driving Cable Cost Increases 9

III. Retransmission Consent Does Not Harm Competition or Consumers 15

A. Network Broadcasters Are Not "Dominant" in the Market for MVPD Programming 16

B. The Commission's Fox-DirecTV Analysis Does Not Support Professor Rogerson or the JCC's Position 18

C. Anecdotal Evidence that Broadcasters and MVPDs Sometimes Fail to Reach Agreement Does Not Imply Broadcasters Have Market Power 21

D. The Offering of a Bundle of Broadcast and MVPD Programming Reflects Economies of Scope and Other Efficiencies, Not Market Power 24

IV. Summary and Conclusions 27

List Of Exhibits

Exhibit One:	Changes in Cable TV Rates, 1999-2004	4
Exhibit Two:	TV Viewing per Household (in hours)	5
Exhibit Three:	Cable Share in Cable TV Households	6
Exhibit Four:	Cable Television Price per Viewing Hour vs. CPI, 1999-2003	7
Exhibit Five:	Programming Expenditures of MVPD Networks	8
Exhibit Six:	Monthly Cable Operator Advertising Revenues per Subscriber, 1999-2004	8
Exhibit Seven:	Cumulative Investment in Plant by Cable Operators, 1999-2004	12
Exhibit Eight:	Revenue from Basic Cable vs. Other Revenues, 2002-2004	13
Exhibit Nine:	Programming Revenue, Programming Expense and Operating Cash Flow, Major Cable Operators, 2002-2004	14

I. INTRODUCTION

We have been asked by The Walt Disney Company to evaluate a report by William P. Rogerson that was submitted to the Federal Communications Commission (FCC or Commission) by the Joint Cable Commenters (JCC) as part of the Commission's *Inquiry on Rules Affecting Competition in the Television Marketplace*.[1] Professor Rogerson and JCC argue that retransmission consent "has been a major contributing factor to the size and price of the expanded basic tier."[2] Specifically, Professor Rogerson concludes that,

> [S]ince the passage of retransmission consent, the Big Four broadcasters have grown to dominate the MVPD network programming industry. Subscription prices for cable TV have risen significantly over the past decade, and there is wide agreement that increases in programming costs have been an important factor fueling these price rises. .... [T]he passage of retransmission consent regulations likely played a major role in contributing to these increases in programming costs by allowing broadcasters to exercise their market power over their broadcast signals.[3]

We examine these issues and conclude that: (a) cable prices are not rising rapidly, especially when adjusted to reflect changes in quality; (b) programming costs account for a very small proportion of recent cost increases experienced by cable operators, the bulk of which are associated with their investments in new digital infrastructure and services such as broadband and telephony; (c) retransmission consent does not harm competition or consumers, but instead contributes to consumer welfare in the markets for broadcast/MVPD programming and distribution.

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[1] William P. Rogerson, "The Social Cost of Retransmission Consent Regulations," (February 28, 2005) (submitted as Attachment A to Comments of Joint Cable Commenters, MB Docket No. 05-28, March 1, 2005). Hereafter, "Social Cost" and "JCC Comments," respectively.

[2] JCC Comments at 5.

[3] Social Cost at 19.

In Section II of this report, we examine the relationship between programming costs and cable rates. Section III focuses on the competitive effects of retransmission consent. Section IV presents a brief summary.

II. PROGRAMMING COSTS ARE NOT DRIVING INCREASES IN CABLE RATES

Professor Rogerson argues that "cable subscription prices have been rising at a very fast rate since passage of the Telecommunications Act in 1996,"[4] and that "there is wide agreement that increases in programming costs have been an important factor fueling these price rises."[5] Retransmission consent is responsible, he says, because it allows broadcasters to "negotiate some combination of higher license fees and increased carriage than they otherwise would have been able to negotiate."[6]

We examined the determinants of cable rates in some detail in a 2003 study.[7] We concluded then that,

> ...cable rates, properly understood, are not rising faster than the rate of inflation – indeed, in real terms they are falling. Moreover, programming costs represent only a small fraction of the overall cost increases experienced by cable TV operators in recent years, and clearly are not the primary driver of retail rates.[8]

In this section, we review the most recent data, and conclude that cable rates, properly understood, are still not rising faster than inflation, and programming costs are still not the primary driver of cable cost structures.

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[4] Social Cost at 17.
[5] Social Cost at 19.
[6] Social Cost at 37.
[7] Jeffrey A. Eisenach and Douglas A. Trueheart, *Rising Cable TV Rates: Are Programming Costs the Villain,* CapAnalysis, LLC (October 23, 2003). Hereafter "2003 Report."
[8] 2003 Report at 1.

A. Quality Adjusted Cable Rates Are Not Rising Rapidly

Each year, the Commission surveys a random sample of cable operators and publishes a report on changes in cable industry prices.[9] The survey provides a basis for estimating prices paid by subscribers for basic and expanded basic (hereafter collectively referred to as "basic") programming services.

At the time of our 2003 report, the data showed that monthly basic subscription rates had risen by 8.2% during in the preceding period (July 2001-July 2002), much faster than the consumer price index, which rose by 1.5%. We argued then, however, that monthly subscription prices fail to take into account changes in quality, such as the number of channels of programming. We showed then that when such factors were taken into account, cable television prices were level or actually falling in real terms. The same results hold today.

The Commission's most recent survey indicates that basic rates increased by 5.4% between January 1, 2003 and January 1, 2004, a period during which consumer prices as a whole, as measured by the rise in the consumer price index, rose 1.1%. Furthermore, over the five-year period ending January 1, 2004 basic cable rates rose at an annual rate of 7.5% compared with 2.1% for the consumer price index. In other words, just as in 2003, the survey seems on its face to suggest that basic cable rates are rising faster than inflation.

As we noted in 2003, however, this data "fails to take into account improvements in product quality, most notably a substantial increase in the number of channels offered

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[9] See Federal Communications Commission, *Report on Cable TV Prices*, MM Docket No. 92-266 (February 4, 2005) (hereafter "Cable Price Report"). (The most recent report moved the reporting period from July-July to January-January.)

as part of basic cable programming packages."[10] Cable subscribers place a high value on programming variety and diversity, as evidenced, for example, by the fact that these product attributes have played a key role in the highly successful efforts of DBS providers to win customers away from cable operators.[11] Thus, it is appropriate to adjust cable subscription prices to reflect changes in the number of channels carried, i.e., to measure cable prices by the cost per channel.

The FCC agrees this is an appropriate basis by which to measure cable rates, and in fact does so in its report. Between January 1, 2003 and January 1, 2004, the Commission reports, the average number of channels carried on the basic tier increased from 67.5 to 70.3. As reflected in Exhibit One below, adjusting the increase in subscription rates to reflect this growth in channels shows that the rate per channel rose by only 1.1% during 2003, and only 0.4% annually over the past five years. Thus, on a per channel basis, over the past five years rates have risen more slowly than inflation.

Exhibit One:
Changes in Cable TV Rates, 1999-2004

	Increase in Average Monthly Rates	Increase in Average Monthly Rate Per Channel	Consumer Price Index
Jan. 2003 to Jan. 2004	5.4%	1.1%	1.1%
5-year average (Jan. 1999 to Jan. 2004)	7.5%	0.4%	2.1%

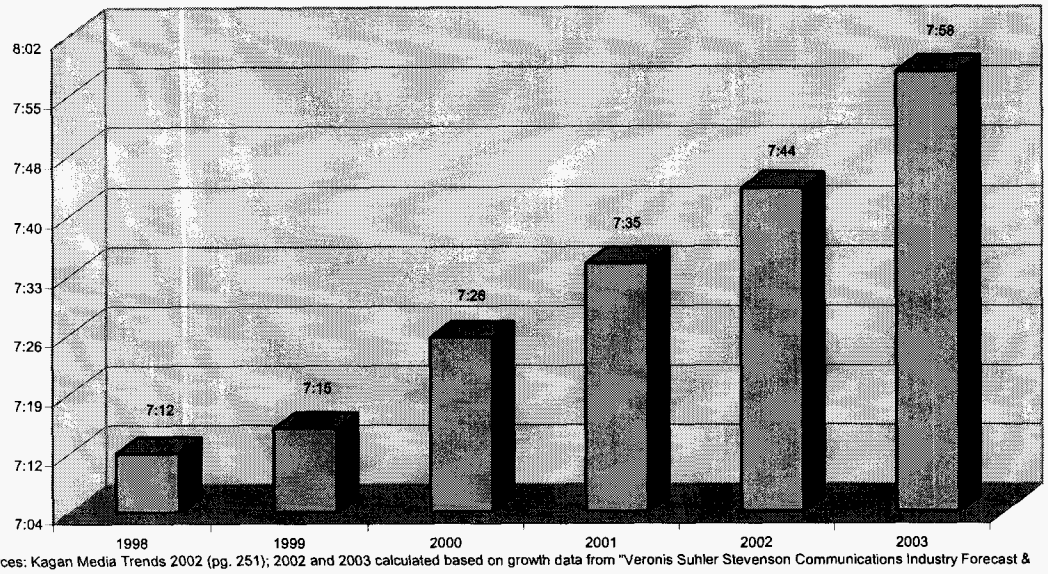
Source: Cable Price Report at 9.

[10] 2003 Report at 4.

[11] See, e.g., the first item on the list of competitive advantages listed by DirecTV on its web page: "The DIRECTV® TOTAL CHOICE® package gives you over 125 digital channels for $41.99/mo, including your local channels. For the same price with cable, you'll typically get 60-90 analog channels." (www.directv.com/DTVAPP/get_directv/directv_vs_cable.dsp, viewed March 28, 2005).

Professor Rogerson suggests that the additional channels being carried on cable networks are of little or no value to consumers.[12] Yet there are numerous indicators that consumers value the increasing quality and diversity of cable TV programming. For example, as shown in Exhibit Two below, the actual viewing time of cable TV households increased by 46 minutes, or more than 10%, between 1998 and 2003. And, as shown in Exhibit Three, cable's share of that time increased as well, from only 50% in 1998 to 60% in 2003.

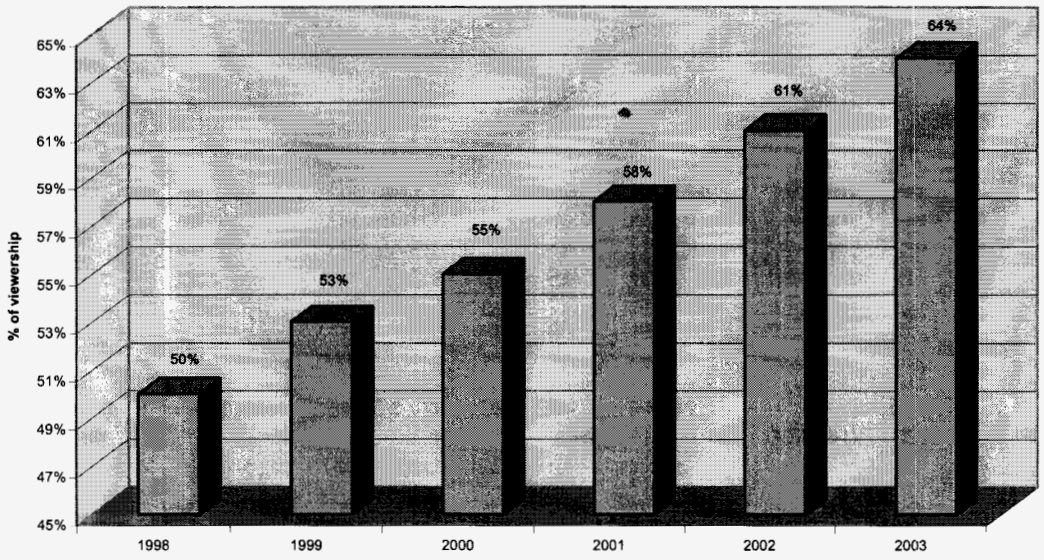
EXHIBIT TWO:
TV Viewing per Household (in hours)



Sources: Kagan Media Trends 2002 (pg. 251); 2002 and 2003 calculated based on growth data from "Veronis Suhler Stevenson Communications Industry Forecast & Report," 2004.

[12] See Social Cost at 4 (arguing that cable operators are forced to "purchase additional programming that they might otherwise not have purchased" and "Consumers also are harmed because these tie-ins...distort the selection of programs that is available to MVPD subscribers.")

EXHIBIT THREE:
Cable Share in Cable TV Households

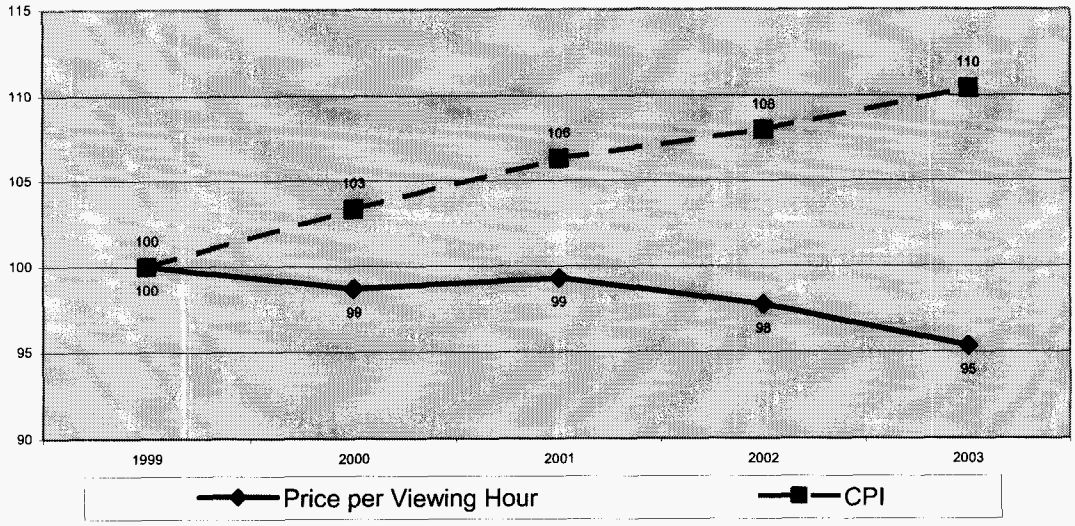


SOURCE: Kagan Economics of Basic Cable Networks 2005 (pg. 46)

Using this above data, we can calculate what is perhaps the most valid measure of the value received by cable subscribers: cost per hour viewed. As reflected in Exhibit Four, the nominal price per hour viewed for cable subscribers decreased at an average annual rate of 1% from 1999 through 2003, while the consumer price index increased at an average annual rate of 2.1% over the same period. Thus, the inflation adjusted price per viewing hour actually decreased by 6.8% during the period.[13]

[13] The conclusion that inflation adjusted price per viewing hour is actually decreasing is also supported by a study by Professor Steven Wildman sponsored by the NCTA. Professor Wildman concluded that the inflation adjusted price per viewing hour decreased by more than 15 percent over the ten-year period from 1993 through 2003. See Steven Wildman, "Assessing Quality-Adjusted Changes in the Real Price of Basic Cable Service" (September 10, 2003; attachment to NCTA Comments in MB Docket 03-172.)

EXHIBIT FOUR:
Cable Television Price per Viewing Hour vs. CPI, 1999-2003
(Index: 1999 = 100)



The increase in TV viewing cited above also suggests that subscribers feel that the quality of the programming being provided has also increased, as evidenced by the fact that the number of prime time Emmys received by cable companies increased by 254% from 1992 through 2003.[14] This increasing quality is not free. As indicated in Exhibit Five below, programming expenditures by the national cable program networks increased at an average annual rate of 14% from 1999 through 2005, much faster average annual increase in cable rates charged to basic subscribers found by the FCC for the same period. [15]

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[14] Social Cost at 58.

[15] The increase in programming costs also reflects increased capital expenditures and operating costs associated with producing digital and high definition content. While these costs are difficult to quantify, in part due to the fact that they have been incurred in large part by independent, privately-held production companies, they are certainly significant.

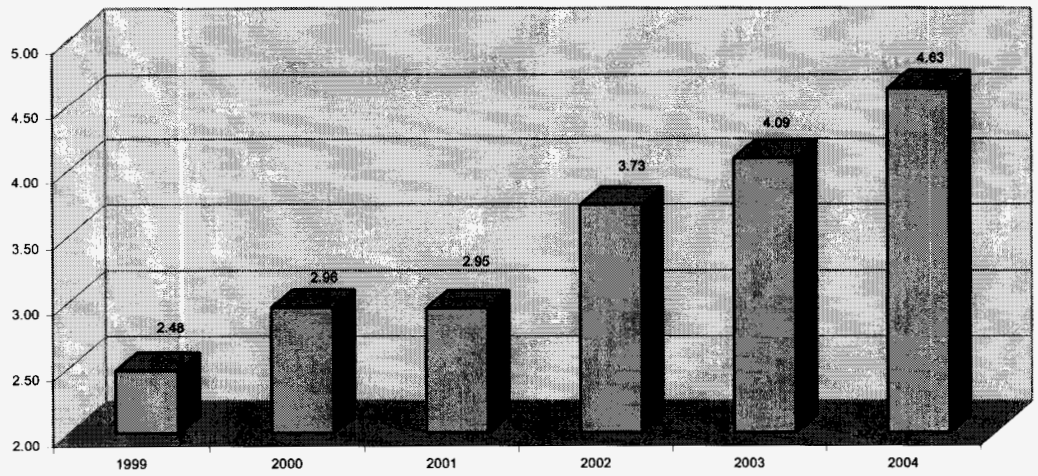
EXHIBIT FIVE:
Programming Expenditures of MVPD Networks

Year	Millions of $	Annual % Change
1999	$6,445	18.0%
2000	$7,265	12.7%
2001	$8,024	10.4%
2002	$9,072	13.1%
2003	$10,413	14.8%
2004	$11,559	11.0%
2005$^{est.}$	$12,862	11.3%

Source: Kagan, "Broadband Cable Financial Databook," 2004.

It should also be noted that that the increase in the quality of programming and the corresponding increase in viewership have resulted in a direct benefit to the cable operators: an increase in advertising revenues. As indicated in Exhibit Six below, on a per subscriber basis net advertising revenue to the cable operators increased by 13% from 2003 to 2004 and by 87% from 1999 through 2004. At least a portion of this increase should be used to offset the costs of programming.

EXHIBIT SIX:
Monthly Cable Operator Advertising Revenues per Subscriber
1999-2004



Source: 2004 Kagan

B. Programming Costs Are Not Driving Cable Cost Increases

Professor Rogerson argues it is "well recognized" that "cable operators' costs of purchasing programming have also been rising at a very rapid rate and that a substantial share of the price increases that consumers have experienced simply reflects a pass-through of these cost increases."[16] In support of this proposition, he cites a March 2004 report by the General Accounting Office,[17] and a 2003 rebuttal, by Rogerson himself, of our October 2003 report.[18] His interpretation of the GAO report is misleading, and his 2003 report is simply incorrect.

Rogerson quotes one paragraph from the 21-page GAO report, which concludes that programming costs are "one important factor contributing to higher cable rates."[19] But GAO also found that "a variety of factors contribute to cable rate increases,"[20] that "the cable industry has spent over $75 billion between 1996 and 2002 to upgrade its infrastructure," and that "investments in system upgrades contributed to increases in consumer cable rates."[21] Perhaps most importantly, the GAO report found that "competition among networks to produce and show content that will attract viewers has become more intense," "bid up the cost of key inputs," "sparked more investment in

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[16] Social Cost at 18.

[17] "Subscriber Rates and Competition in the Cable Television Industry," *Statement of Mark L. Goldstein, Director, Physical Infrastructure Issues, U.S. General Accounting Office, Before the Committee on Commerce, Science and Transportation, U.S. Senate*, (March 25, 2004). (Hereafter "GAO 2004.") (The GAO's name has since been changed to the "Government Accountability Office.")

[18] William P. Rogerson, Correcting the Errors in the ESPN/CapAnalysis Study on Programming Cost Increases (November 11, 2003). (Hereafter, Rogerson 2003.) Rogerson's rebuttal was commissioned by Cox Communications at a time when Cox seeking to justify *a la carte* regulation of cable programming on the grounds that cable rates were rising and that programming costs (specifically, ESPN's license fees) were to blame. See below for a discussion of Cox's "revised and extended" views on this issue.

[19] GAO 2004 at 3.

[20] GAO 2004 at 9.

[21] GAO 2004 at 11.

programming," and "improve[ed] the quality of programming generally."[22] All of these findings are consistent with our analysis above, and explain why any meaningful analysis of cable rates and programming costs must take into account changes in the quality and quantity of programming being offered to cable subscribers.

Rogerson's second citation for the proposition that programming costs are responsible for rising cable rates is his own report. Based on our 2003 empirical analysis of MVPD cost structures, he calculated that net programming costs (after a partial correction to reflect the value of increasing advertising revenues) had risen by $2.96 per subscriber between 1999 and 2002, and then compared that figure with the increase in basic cable rates of $7.06 over that period of time. His conclusion, which he repeats in his new report, is that "42% [$2.96/$7.06] of the actual rise in subscription prices for cable TV can be explained by the rise in programming costs in the sense that this is the amount prices would have had to rise in order for cable systems to recover their increased programming costs."[23]

This conclusion is nonsense, as can been seen by applying Rogerson's methodology to the rest of the cost picture (which we presented as part of the same analysis from which Rogerson drew his $2.96 figure).[24] When we look at other costs, we see that "Capital Expense" rose by $5.05 between 1999 and 2002, while "Other Operating Expense" rose by $7.33. If we applied Rogerson's methodology to these figures (i.e., divide each by the $7.06 increase in monthly cable rates) we would conclude that Capital Expenses "explain" 72% ($5.05/$7.06) of the "actual rise in

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[22] GAO 2004 at 10.
[23] Rogerson 2003 at 7.
[24] See 2003 Report at 12, Figure 5.

subscription prices," while Other Operating Expenses "explain" 104% ($7.33/$7.06). The three factors taken together, in other words, "explain" 218% (42% + 72% + 104%) of the rise in cable prices.

Our 2003 conclusion – that programming costs accounted for only about 22% of the increase in cable costs between 1999 and 2002 – was based on a detailed examination of cable system expenses over that period of time. We found then that the increases in capital spending and non-programming operating costs associated with the cable operators' decision to upgrade their networks to provide digital television, Internet access, telephony and other services, were a "far more significant source of cost increases than programming."[25] We also noted that the advanced broadband, telephony and HDTV services made possible by the cable operators' investments "have not yet been fully realized; and thus despite the fact that they are not yet benefiting from the increased costs of the new technologies, basic cable subscribers are bearing the costs of these upgrades."[26]

Now, nearly three years later, the transition from analog to digital is largely complete. As shown in Exhibit Seven below, cumulative capital expenditures now total over $80 billion (about $1,250 per subscriber), but as of 2004, 97% of cable subscribers were served by systems offering digital programming, 95% by systems offering cable internet access and 29% by systems offering telephony.[27]

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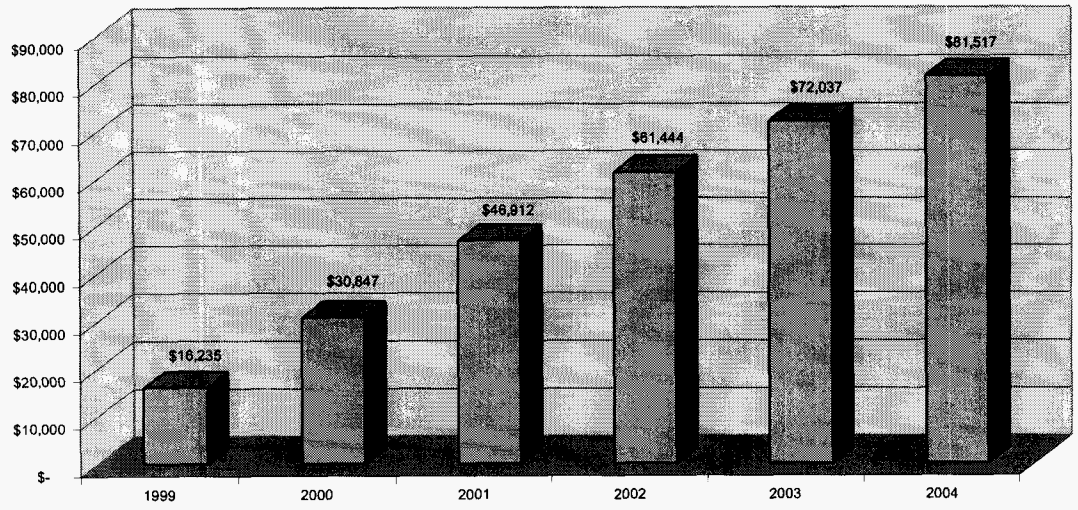
[25] 2003 Report at 17. Our findings were largely in accord with those of a May 2003 NCTA White Paper. See National Cable & Telecommunications Association, "Cable Pricing, Value and Costs," NCTA White Paper (May 2003).
[26] 2003 Report at 17.
[27] Cable Price Report at ¶37, Table 10.

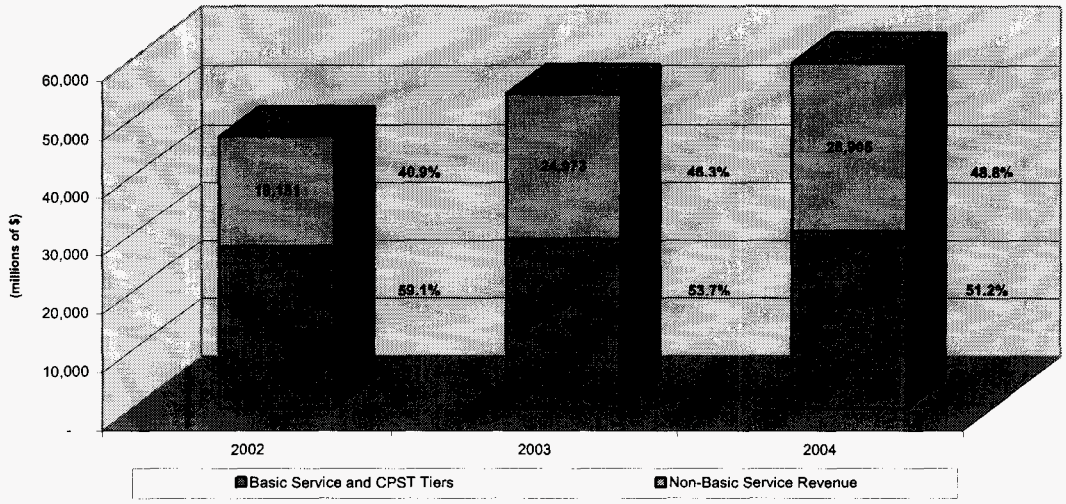
EXHIBIT SEVEN:
Cumulative Investment in Plant by Cable Operators
1999-2004 ($ million)



SOURCE: Kagan World Media, " Broadband Cable Financial Databook 2004

Not surprisingly, as illustrated in Exhibit Eight below, revenue from advanced services has grown at a far more rapid rate than revenue from basic service, growing by 51% from $19.1 billion in 2002 to $28.9 billion in 2004, compared with growth in basic service revenue of only 9.6% over the same period. Non-basic revenue represented just over 40% of total revenue in 2002, but had grown to nearly 49% in 2004.

EXHIBIT EIGHT:
Revenue from Basic Cable vs. Other Revenues, 2002-2004



SOURCE: Kagan, "Broadband Cable Financial Databook," 2004.

The rising revenue share accounted for by advanced services raises important methodological issues with respect to the correct allocation of costs, however. As the Commission recognizes in its Cable Price Report,

> The nature of cable service has changed significantly in recent years with the emergence of digital cable, Internet access, and telephony as important new services so that these new services now represent significant sources of cable system revenues and costs. A substantial portion of these costs are incurred to support all system services jointly and, therefore, cannot be attributed directly to basic and expanded basic cable services.[28]

Thus, "there is no uniform way to allocate these joint costs to specific lines of business or service"; and, "to provide a complete picture, it would be necessary to take into account revenue changes that might offset increases in costs."[29]

We agree that cable operators' changing revenue structures now make it practically impossible to accurately allocate costs across different services, and we

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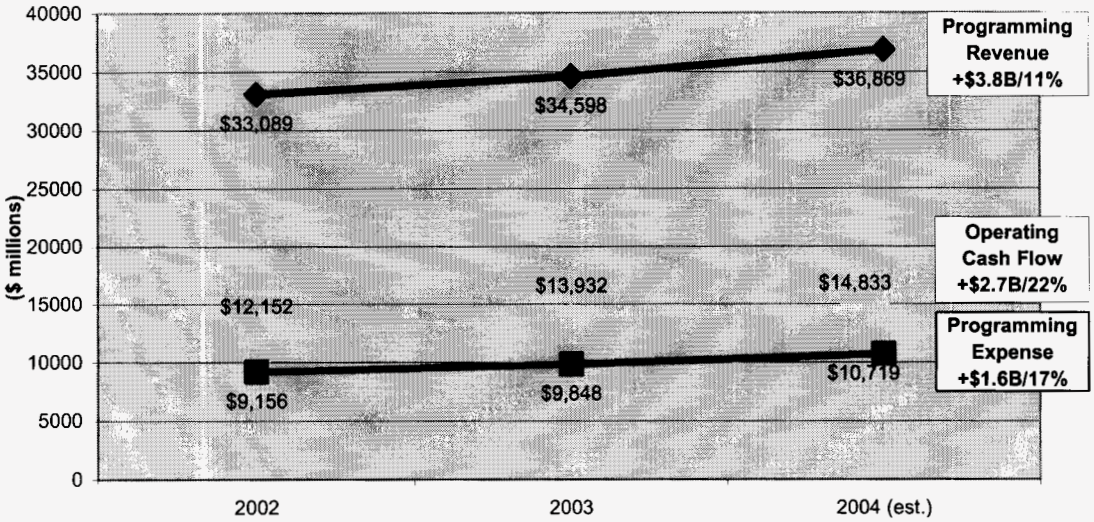
[28] Cable Price Report at 10.
[29] Cable Price Report at 10.

therefore do not attempt to update our 2003 estimates.[30] In Exhibit Nine, we show total cable programming costs, programming revenues and overall operating profits for the seven largest cable operators for 2002-2004. While programming costs rose by $1.6 billion, both revenues (+$3.8 billion) and operating profits (+$2.7 billion) rose by much more; and, programming costs represent less than 30% of revenues throughout the period.[31] These figures show that our 2003 conclusion, that programming costs "are not a primary driver of retail rates," remains valid today.

EXHIBIT NINE:
Programming Revenue, Programming Expense and Operating Cash Flow
Major Cable Operators, 2002-2004



SOURCE: Morgan Stanley Equity Research Report, "Bundling and the Battle for Basic," October 12, 2004.

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[30] We believe, however, that our 2003 results are still broadly representative of the relationships between programming costs and other costs for basic cable service – i.e., that programming represents a relatively small fraction of total costs.

[31] Two caveats: First, these figures represent total programming cost, much of which is associated with programming not owned by broadcasters and thus not affected by retransmission consent. Second, the reader who may be tempted to divide $1.6 billion by $3.8 billion and conclude that "42% of the actual rise in subscription [revenues] for cable TV can be explained by the rise in programming costs in the sense that this is the amount [revenues] would have had to rise in order for cable systems to recover their increased programming costs," should first see the discussion at 10-11 above.

To summarize: (a) cable prices, properly adjusted to reflect changes in the quantity and quality of programming, are not rising faster than inflation and, (b) programming costs are not primarily responsible for even the nominal increases in cable prices that have taken place since 2002.

III. RETRANSMISSION CONSENT DOES NOT HARM COMPETITION OR CONSUMERS

Professor Rogerson and JCC assert retransmission consent imposes costs on consumers by enhancing the "dominance of the major broadcast networks,"[32] who leverage their market power by bundling their "must have" local broadcast channels with MVPD network programming to "force MVPDs to (1) pay higher prices for program networks that they might have purchased in any event and (2) purchase additional program networks that they would not otherwise have purchased."[33] Moreover, and "most importantly," according to Rogerson, "this will likely damage competition by either preventing the entry of competitors or at least weakening them,"[34] which "may be one of the primary motives for bundling in the first place."[35] Moreover, he argues at length, the Commission has already endorsed this view in its Fox/DirecTV.

As we explain in detail below, each and every aspect of this argument is faulty, either factually, analytically or both. Broadcasters are by no meaningful measure "dominant" in MVPD programming. They do not "force" MVPDs to carry additional networks, but instead offer the alternative of payment for broadcast channels on a stand-alone basis. They do not have "market power" in the sense of being able to force

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[32] Social Cost at 10.
[33] Social Cost at 50.
[34] Social Cost at 51.

anticompetitive or supracompetitive prices or terms on MVPDs; rather, to the extent bundling takes place, it is motivated by efficiency concerns. And, as the Commission has pointed out previously, its findings in Fox/DirecTV unequivocally *do not* support the findings being urged upon it by Professor Rogerson and the JCC.

A. Network Broadcasters Are Not "Dominant" in the Market for MVPD Programming

Professor Rogerson claims that "The four major broadcast networks are now collectively the predominant suppliers of satellite-delivered networks."[36] But in fact, broadcaster MVPD owned-networks are far from dominant in any meaningful sense of the word.

According to the FCC's most recent report on competition in the MVPD sector, the 89 broadcast-owned cable networks "represent 23 percent of the 388 total networks identified, and 30 percent of the 299 networks that are unaffiliated with a cable operator."[37] Moreover, the Commission found, the number of new networks is growing: "Since our last *Report*, the total number of national networks has increased. In 2004, we identified 388 satellite-delivered national programming networks, an increase of 49 networks over the 2003 total of 339 networks. Of the 388, 89 networks (23 percent) were vertically-integrated with at least one cable operator in 2004. Last year, 110 networks were vertically integrated (33 percent) of the 339 total."[38]

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[35] Social Cost at 51.
[36] Social Cost at 17.
[37] *In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, Eleventh Annual Report* (MB Docket No. 04-227, February 4, 2005), at ¶148. (Hereafter MVPD Report.)
[38] MVPD Report at ¶145

As a result, the Commission concluded, "[I]t appears there is diverse ownership of the most popular networks: 10 different entities own all or part of the top 20 programming networks in terms of subscribership."[39]

Even the statistics presented by Professor Rogerson do not support his argument. According to his calculations, no entity owns more than 21 percent of MVPD programming networks; the four major broadcast networks taken together own only 56.5 percent;[40] six cable MSOs own 25.9 percent; and, unaffiliated programmers own 17.6 percent. These figures are far more consistent with the Commission's findings of of diverse and unconcentrated ownership than with Rogerson's assertion of "dominance." Indeed, we used Professor Rogerson's market share statistics for 2004 to calculate a Herfindahl-Hirschman Index (HHI) of 1219,[41] which lies at the bottom end of the "moderately concentrated" range, and is not significantly different from the 1097 HHI figure the FCC estimates for MVPD distributors.[42] In other words, even using Professor Rogerson's figures, the MVPD programming industry and the MVPD distribution business are approximately equally "concentrated."[43]

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[39] MVPD Report at ¶150.

[40] It should be noted that we do not endorse Professor Rogerson's methodology for calculating market shares. He attributes partial ownership to total market shares – e.g., if a broadcast company owns 10% of a cable network, then 10% of that cable network's revenues are attributed to the broadcast company (see Social Costs, n.3). There is no reason to believe, however, that a 10% share accords the owner of the network sufficient control (or even influence) to affect strategic behavior. The Commission takes a different approach to calculating shares. See MVPD Report at ¶144, n. 648.

[41] We relied on the figures in Rogerson's Table 2, p. 8, leaving out the 13 percent total market share attributed to "Others." Since the individual shares of each of the "others" are small, this omission will have no significant impact on the HHI calculation.

[42] MVPD Report at ¶144.

[43] This is true, of course, only at the national level. At the level of local markets, the distribution business typically is comprised of only three competitors – cable and the two satellite MVPDs – with HHIs in excess of 3000 (i.e., well above the DOJ Guidelines threshold of 1,800 for a "highly concentrated" industry). The FCC classifies only 3.7 percent of downstream MVPD markets as "competitive." MVPD Report at ¶136.

These structural characteristics of the MVPD marketplace imply that broadcasters should not be able to negotiate higher license fees from MVPD networks than other MVPD programmers. Not surprisingly, this is precisely what the General Accounting Office concluded when it conducted an econometric study of this precise issue in 2003.[44] That study found that "ownership affiliations – with broadcasters or cable operators – had no influence on cable networks' license fees."[45]

B. The Commission's Fox-DirecTV Analysis Does Not Support Professor Rogerson or the JCC's Position

Professor Rogerson's next argument is founded on his insistent misinterpretation of the Commission's findings in the Fox/DirectTV order. There, Rogerson says, the Commission found that there are not close substitutes for local broadcast content, and that News Corp. therefore had some bargaining power in its negotiations with MSOs.[46] Professor Rogerson makes much of this finding, which he insists supports his conclusion that broadcasters are able to use retransmission consent to raise prices and/or force un-economic contractual provisions on MSOs.

In fact, the Commission has repeatedly found precisely the opposite to be true. In a passage from the Fox/DirecTV order that appears just a few pages prior to the passages cited by Professor Rogerson, the Commission found that:

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[44] General Accounting Office, *Issues Related to Competition and Subscriber Rates in the Cable Television Industry* (GAO-04-8, October 2003). (Hereafter "GAO 2003.")

[45] GAO 2003 at 29. Professor Rogerson attempts to explain away this result in a lengthy footnote, but offers no substantiation for any of his speculative criticisms. Rogerson also points out that the GAO study finds evidence that program networks offered by broadcasters are more likely to be carried by MVPDs than unaffiliated program networks, a fact he says is consistent with his contention that broadcasters use retransmission to get cable operators to carry their networks. Rogerson neglects to mention, however, that the GAO study finds that *programming networks affiliated with cable operators* are also more likely to be carried than unaffiliated networks. This result may be explained as easily by efficiency concerns as by market power – i.e., it may be that both broadcasters and cable operators enjoy economies of scope or other cost advantages that make them more efficient producers and/wholesalers of cable programming.

[46] Social Cost at 24-27 citing Fox/DirecTV order at ¶¶201, 202, 203.

> Both programmer and MVPD benefit when carriage is arranged: the station benefits from carriage because its programming and advertising will likely reach more households when carried by MVPDs than otherwise, and the MVPDs benefit because the station's programming adds to the attraction of the MVPD subscription to consumers. Thus, the ***local television broadcaster and the MVPD negotiate in the context of a roughly even 'balance of terror'*** in which the failure to resolve local broadcast carriage disputes through the retransmission consent process potentially damages each side greatly in their core business endeavor.[47]

As clear as this language would seem to be, it did not prevent commenters in the Commission's recent *a la carte* proceeding from attempting to take out of context some of the same language relied upon by Professor Rogerson. Thus, the Commission took pains in its report to Congress to clarify its finding:

> All differentiated products, such as video programming, possess some degree of market power in the sense that there are no perfect substitutes. The critical question in any analysis involving differentiated products is whether the existing degree of market power is sufficient to allow the firm to profitably engage in the hypothesized anticompetitive activity.... ***Thus, nothing in the analysis of the News Corp./DirecTV transaction should be read to suggest that the Commission has concluded that the market power of broadcasters is sufficient to lead to competitive harms in the absence of vertical integration.***[48]

In view of this extremely clear statement, there is simply no justification for Professor Rogerson's insistence that "the Commission's conclusion that broadcasters have market power ... implies that retransmission consent allows broadcasters to

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[47] *In the Matter of General Motors Corporation and Hughes Electronics Corporation, Transferors and The News Corporation Limited, Transferee for Authority to Transfer Control, Memorandum Opinion and Order* (MB Docket No. 03-124, January 14, 2004), at ¶180. (emphasis added). See also ¶75 ("We agree with the Applicants that the instant transaction does not present horizontal concentration issues. The Commission has previously held that broadcast television is not sufficiently substitutable with the services provided by MVPDs to constrain attempted MVPD price increases, and hence, is not in the same relevant product market.") (Hereafter "Fox/DirecTV Order.")

[48] *Report on the Packaging and Sale of Video Programming Services to the Public* (November 18, 2004), p. 70 (emphasis added). (Hereafter "A La Carte Report.") This language appears in the same paragraph as several sentences cited by Professor Rogerson.

negotiate significant compensation from MVPDs ... [and] means that retransmission consent regulations create a significant social cost."[49]

Nearly as remarkable as Professor Rogerson's persistence is the irony inherent in JCC's attempt to argue that the Fox/DirecTV order has implications for this proceeding, when these same filers (plus Cable One) went out of their way in that proceeding to insist that the issues there were "unique," "singular" and unrelated to any "rulemaking proceeding." "The issues raised by the Joint Cable Commenters are transaction specific," they said.

> The fact that [retransmission negotiation] issues may touch upon generic concerns regarding retransmission consent and sports programming costs is of no moment, since ***it is the DirecTV acquisition itself that increases News Corp's incentive and ability to wield undue pricing power and bargaining leverage*** in connection with its broadcast stations and RSNs....
>
> Moreover, in this instance there [*sic*] no rulemaking proceeding that addresses the issues raised by the Joint Cable Commenters. Indeed, no other entity has ever owned and operated the unique combination of broadcast network, local stations, cable programming, and multichannel distribution assets involved in this transaction. ***It is the very singularity of the asset combination involved here that triggers the competitive and consumer harms raised by the Joint Cable Commenters*** and others in connection with this transaction."[50]

In fact, JCC said then, in the absence of the merger, News Corp. would be constrained by uncertainty if it tried to exercise market power in retransmission negotiations:

> Prior to acquiring a controlling interest in DirecTV, News Corp. faces some risk and uncertainty [in retransmission consent negotiations]. It does not know whether the loss of subscription and advertising revenue from a service interruption arising from a temporary bargaining impasse with a cable operator over carriage of RSN or FOX programming could be made

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[49] Social Cost at 26.

[50] Letter from Bruce D. Sokler to Marlene H. Dortch, *Notice of Ex Parte Participation in MB Docket No. 03-124* (August 4, 2003), at 11-12. (The "Joint Cable Commenters" in that proceeding were the same as here, except that Cable One was also among the commenters in the earlier proceeding.)

> up via higher carriage fees gained from that distributor (and others in adjacent markets) once the impasse is resolved.[51]

In other words, in the absence of vertical integration, broadcasters cannot know whether they have an upper hand in the negotiations or not.

Finally in this context, we note that if their investigation of Fox/DirecTV had caused antitrust authorities to have concerns about joint ownership of broadcast and MVPD programming properties, they had ample opportunity to act on those concerns in the Spring of 2004, when they reviewed the merger of broadcaster GE/NBC with the cable and other entertainment properties of Vivendi's Universal Entertainment Group. But, despite the fact that concerns about the impact of the merger on retransmission negotiations were explicitly raised, the deal cleared antitrust reviews in both the European Union and the United States without any conditions being imposed. Final approval was granted in April 2004, just four months after the FCC's order in Fox/DirecTV.[52]

C. Anecdotal Evidence that Broadcasters and MVPDs Sometimes Fail to Reach Agreement Does Not Imply Broadcasters Have Market Power

Professor Rogerson seeks to portray the bargaining that goes on between broadcasters and MVPDs as one-sided, citing instances in which negotiations between programmers and broadcasters have led to a temporary impasse, and arguing that

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[51] Sokler Letter at 3-4. Professor Rogerson's report in the DirecTV/Fox merger also focused on the increased market power Fox allegedly would enjoy "because the lasting losses to the rival MVPD resulting from the fact that that customers shift to DirecTV will become lasting gains for News Corp., the owner of DirecTV." See William P. Rogerson, *An Economic Analysis of the Competitive Effects of the Takeover of DirecTV by News Corp.*, (June 13, 2003).

[52] See Jayne O'Donnell, "NBC Vivendi Merger Hits Possible Snag," *USA Today* (December 31, 2003) (available at http://www.usatoday.com/money/media/2003-12-31-merger_x.htm, viewed March 18, 2005); see also Letter from Susan Creighton, Director, Bureau of Competition, to Brackett B. Denniston, General Counsel, General Electric, (April 20, 2004) (available at http://www.ftc.gov/os/closings/staff/040420ge.pdf, viewed March 18, 2005).

these anecdotes are evidence that broadcasters have the superior position in the negotiations by virtue of their "must have" programming.[53]

Negotiations between broadcasters and MVPDs can perhaps accurately be characterized, as the Commission has put it, as a "balance of terror."[54] But the notion that cable operators are lacking in bargaining leverage and thus are always forced to capitulate to broadcasters is at variance with the facts.

For example, as this is written, Cox Communications and the Washington Post Company are in an extended dispute with Nextar Broadcasting over carriage of Nextar's CBS- and NBC-affiliated local broadcast stations in four markets (Abilene, San Angelo, and Texarkana, Texas, and Joplin, Missouri). Nextar pulled its signals off the four cable systems effective January 1, 2005, insisting on some form of financial compensation for carriage of its programming. If Professor Rogerson were right – that broadcasters have substantial market power over MVPDs – we would have expected the cable systems to accede quickly to Nextar's demands. Instead, after three months, the dispute continues. As the Commission predicted, both sides are suffering from the impasse, but certainly there is no evidence that the cable systems are suffering more. Indeed, according to a report in *Broadcasting & Cable*, the impasse has led to a 40 percent increase in demand for television "rabbit ears" (which have also been offered for free by the cable companies), and forced Nextar to reduce its advertising rates by 30 percent.[55]

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[53] Social Cost at 20-21.

[54] News Corp/DIRECTV, at ¶180.

[55] See John M. Higgins and Bill McConnell, "No Cash, No Carry," *Broadcasting & Cable* (February 7, 2005) (available at http://www.broadcastingcable.com/index.asp?layout=articlePrint&articleID=CA501628, viewed March 21, 2005). It should be noted that at last one of the stations, KRBC Channel 9 in Abilene, is available on the Dish Network – a fact which, according to Professor Rogerson, should further weaken the bargaining

Companies involved in such negotiations may also seek to strengthen their negotiating positions by leveraging the legal/political/regulatory process, as was the case in recent licensing negotiations between Cox and ESPN.[56] In May 2003, Cox Communications Chairman James Robbins testified before the Senate Commerce Committee in favor of legislation that would force companies like Disney/ESPN to offer their programming *a la carte*. At the time, Cox was nearing the end of its carriage agreement with ESPN, and the *a la carte* proposal was seen as a way for Cox to increase its bargaining leverage vis-à-vis ESPN in the negotiations.

In March 2004, after the negotiations had been successfully completed, Mr. Robbins appeared again before the Committee, but this time testified that *a la carte* was "not in consumers best interests." Noting this surprising change in position, Chairman McCain queried Mr. Robbins: "When did you find yourself on the road to Damascus?" Chairman McCain asked.

"As soon as [ESPN President] Mr. Bodenheimer got real in his pricing," Mr. Robbins replied. "My efforts last spring to move ESPN ... to a tier was to get the attention of the Walt Disney Company and bring them to reasonable levels of prices."[57]

One might draw several conclusions from these episodes, but the most obvious is that both broadcasters and cable companies have multiple weapons in their negotiating arsenals, from giving away free rabbit ears to lobbying Congress (or the

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power of the local cable system and lead to a quick capitulation. See www.krbctv.com, viewed March 23, 2005.

[56] While the Cox-ESPN negotiations did not involve broadcast retransmission consent, the episode nonetheless illustrates clearly how public policy can become at negotiating tool in such situations.

[57] Hearing Of The Senate Commerce, Science, and Transportation Committee, "Escalating Cable Rates: Causes And Potential Solutions," *Federal News Service* (March 25, 2004), at 32-33.

FCC) for new regulations. But to argue, as Professor Rogerson does, that one side has disproportionate leverage is simply at variance with the facts.[58]

D. The Offering of a Bundle of Broadcast and MVPD Programming Reflects Economies of Scope and Other Efficiencies, Not Market Power

While Professor Rogerson refers repeatedly to "bundling" and "tie-ins," at least some broadcasters do not engage at all in tying (i.e., the refusal to sell their broadcast programming unless cable operators also carry their MVPD programming), and engage in only the most innocuous form of bundling (i.e., they offer discounts on sales of multiple products).[59] Moreover, as Professor Rogerson has argued in other contexts, it is well established in the economics literature that bundling is often economically efficient. Indeed, in his report in the *a la carte* proceeding, Professor Rogerson offers a spirited defense of the practice:

> Standard economic theory suggests that some bundling and tiering of programming is likely to be efficient, that the precise form of the efficient tiering scheme is likely to depend in complex ways on market conditions that cable systems will understand better than regulators, and that cable systems will generally have an incentive to choose efficient tiering schemes because cable systems can charge subscribers higher prices by providing them with packages of services they value more highly.[60]

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[58] The notion that broadcasters gain materially from owning MVPD networks is also challenged by Viacom Chairman Sumner Redstone's proposal to break the company into two separate divisions, thereby separating the CBS network and stations from Viacom's MTV Network cable networks. Redstone's rationale is that MTV's affiliation with CBS *lowers* its market capitalization, a conclusion that is explicitly contrary to Professor Rogerson's "leveraging" theory. See John Higgins, "Double Your Pleasure: Viacom Chairman Redstone Explains His Plan to Split Up an Empire," *Broadcasting & Cable* (March 21, 2005) at 18-19. ("Redstone says that, today, MTV is locked up in a company that trades at around eight times annual cash flow, a relatively low valuation. 'Separated, I believe, it will have a multiple of 16. That alone is an enormous change.'")

[59] On the practices of the broadcasters, see Comments of the Walt Disney Company in this proceeding. This form of bundling is often referred to as "mixed bundling." See Barry Nalebuff, *Bundling, Tying and Portfolio Effects: Conceptual Issues*, United Kingdom, Department of Trade and Industry (February 2003), at 13-17. (Hereafter "Nalebuff 2003.")

[60] William P. Rogerson, "Cable Program Tiering: A Decision Best and Properly Made by Cable System Operators, Not Government Regulators," (November 10, 2003), at 6. (Hereafter "Tiering.") Professor Rogerson acknowledges that his view of bundling is different in the two proceedings, and says the difference is due to the fact that "The economic motivations that MVPDs have to bundle programming at the retail level are very different than the economic motivations that explain the type of bundling that

> ...
> [I]t seems likely that profit maximizing firms will generally have an incentive to bundle products efficiently. This is simply because they can charge consumers more money by providing them with packages that better fill their needs.[61]
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> ...
> [E]ven a firm with market power will generally want to supply its customers with their most preferred mix and packaging of products because it will be able to charge consumers the highest possible price by so doing.[62]
>
> ...
> Allowing government to regulate how firms with market power bundle products will only increase the likelihood that the firms do not offer the most efficient bundle of products, but will not prevent them from charging monopoly prices for whatever bundles of products they do sell.[63]

Needless to say, Professor Rogerson takes a different view of bundling when it is undertaken by broadcasters in their negotiations with cable companies, arguing that the broadcasters are using bundling to "leverage" their market power over one good (broadcast channels) into markets for related goods (cable networks).[64] Specifically, based on an article by Michael D. Whinston,[65] he argues that "it seems likely that an additional motivation broadcasters may have to bundle retransmission consent together with other network programs is to capture larger market shares from their potential competitors and thereby either foreclose them from entering entirely or at least weaken them."[66]

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occurs in the case of bundling of retransmission consent together with cable channels at the wholesale level." (See Tiering at n. 65.) Nowhere, however, does he explain why.

[61] Tiering at 10-11.

[62] Tiering at 11.

[63] Tiering at 12.

[64] Social Cost at 47. In the preceding section, Professor Rogerson offers a several possible explanations for why both the cable operators and the broadcasters may have preferred "in kind" compensation to cash compensation for retransmission. While some of these explanations may well be valid, they have little or nothing to do with whether the practice enhances or detracts from consumer welfare.

[65] Michael D. Whinston, "Tying, Foreclosure, and Exclusion," *American Economic Review* 80;4 (September 1990), 837-859.

[66] Social Cost at 48.

But neither the Whinston article nor the broader literature on bundling suggests that the conditions in the MVPD programming market are conducive to anticompetitive bundling. Whinston's result, for example, is described by Professor Rogerson as showing that bundling can be effective as a means of leveraging market power when at least one of the bundled products is characterized by increasing returns to scale. Since television production is indeed characterized by increasing returns, he concludes that is what must be happening here.

But Whinston's result applies only in a very narrow set of circumstances which do not appear to apply to this market;[67] and, in general, the circumstances in which bundling may be used to achieve anticompetitive ends are extremely limited, especially, as here, when at least one of the markets involved is fully competitive.[68] Certainly, Professor Rogerson does not demonstrate that the conditions for anticompetitive bundling are present in the market for MVPD programming.

A close reading of Professor Rogerson's report and the JCC comments suggests that their real complaint is that broadcasters are being successful in their competition with vertically integrated MVPD networks to produce and market MVPD programming, i.e., that the "bundling" of which they complain is simply that broadcasters are producing and successfully marketing both broadcast and cable programming. But the success of

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[67] For example, his result holds for products with independent demand only if the seller is able to pre-commit never to unbundle the goods in future periods. Such pre-commitment would not be possible in the market for television programming, where contracts are negotiated every three years. (See Whinston at 841-46.)

[68] Even Professor Nalebuff, one of the leading exponents of anticompetitive theories of product bundling, concedes that "There is often a presumption that firms can leverage power from one market to another. The Chicago School argument provides some surprisingly general conditions under which such leverage is not possible. It is particularly difficult to increase profits by using monopoly power to create leverage into competitive markets." (See Nalebuff 2003 at 19.)

broadcasters in the MVPD programming marketplace is almost certainly the result of economic efficiency, as Professor Rogerson explains in his report:

> [T]here are significant 'economies of scope' for the networks between producing programming for their own use and producing programming that can be shown on MVPD networks. Once the networks were acquiring and/or producing significant amounts of content for use on their broadcast outlets, they found that they could use substantial amounts of in-house content that already existed and produce additional content at a relatively low incremental cost for distribution on affiliated MVPD networks. In many cases, this gave them a competitive advantage over other rivals....[69]

Thus, he concludes,

> [T]he networks would have entered the MVPD network programming industry to some extent regardless of whether or not retransmission consent had been enacted.[70]

On these points we agree with Professor Rogerson entirely.

IV. SUMMARY AND CONCLUSIONS

In summary, JCC and Rogerson misapprehend both the cause and the effect in this matter. With respect to the effect, it simply is not the case that cable television prices are rising rapidly, or that MVPDs are being forced to carry networks consumers do not want to watch. Quality-adjusted prices are rising less rapidly than inflation, and consumers are watching more cable television every year.

With respect to cause, retransmission consent does not lead to anticompetitive effects in the market for MVPD programming. To the contrary, retransmission consent is nothing more or less than a *de facto* property right – the right of local broadcasters to benefit from the fruits of their investments in creating programming and packaging news

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[69] Social Cost at 14-15.
[70] Social Cost at 17.

and entertainment for the benefit of consumers. Such property rights are essential for, not an obstacle to, the creation of efficiently functioning competitive markets.

THE FAIR MARKET VALUE

OF LOCAL CABLE RETRANSMISSION RIGHTS

FOR SELECTED ABC OWNED STATIONS

BY

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AND

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JULY 15, 2004

ECONOMISTS INCORPORATED

WASHINGTON DC

EXECUTIVE SUMMARY

The analysis examines the fair market value of local cable retransmission rights for ABC owned broadcast television station signals in three DMAs—Philadelphia, Flint, and Toledo.[1] (These stations will be referred to individually as an "ABC Owned Station" and collectively as the "ABC Owned Stations.") The analysis is based on three benchmarks. The first benchmark begins with an estimate of the retail price charged for the ABC Owned Station signals by DirecTV and DISH Network and works back to a corresponding license fee. The second benchmark begins with an estimate of what a local cable operator in each area charges its subscribers for the ABC Owned Station signal, and works back to a corresponding license fee. The third benchmark starts with an econometric analysis of the relationship between the license fees of basic cable networks and what those networks spend on programming, and then estimates the license fees that the ABC Owned Station signals would have commanded, given ABC's expenditures on programming, had they been basic cable networks. Using the average of the estimates produced by the benchmarks in each market, the fair market value of the retransmission right for the ABC Owned Station signals in the markets considered ranges from $2.00 to $2.09 per subscriber per month.

[1] These markets were selected for analysis by ABC. The three markets include one large market, Philadelphia, and the two smallest markets in which ABC owns stations.

INTRODUCTION

Local broadcast stations, especially network affiliates, are an important part of the services provided by cable systems. Indeed, cable television got its start more than 50 years ago by offering improved reception of local broadcast station signals. Although cable systems now offer many other services, local broadcast station signals remain a key source of consumer demand for cable. This is not surprising. Local broadcast stations carry popular local news, weather and sports programming. Also, the national network entertainment, news and sports programming carried by network affiliates remains among the most popular programming on television. Actual and potential cable subscribers place a high value on this programming.

Cable carriage of local broadcast station signals produces revenues for cable operators. A cable operator may charge a higher subscription price for a package of programming networks if local broadcast station signals are included in the package. Alternatively, at any given subscription price, there will be more subscribers and more subscription revenue if local broadcast station signals are carried. Further, having more subscribers means that the cable operator can generate more revenue from the sale of local advertising and other services. In these respects, local broadcast station signals play a role similar to popular cable networks and other sources of cable content.

In order to generate subscriber and advertiser revenues, cable operators distribute cable networks, such as A&E, CNN, and Discovery, to their subscribers and pay monthly per subscriber fees to cable networks for such rights. Most cable networks sell advertising spots to national advertisers, and some also provide local ad availabilities to cable operators who in turn sell such local advertising spots to local advertisers.

Federal law establishes two methods by which cable systems carry local broadcast station signals—must carry and retransmission consent. Under must carry, cable systems are not required to pay local broadcast stations for the right to distribute the local broadcast station signals that they are required by federal law to carry. However, a local broadcast station may elect instead to exercise its right to grant retransmission consent. Under retransmission consent, cable systems are not required to carry the local broadcast

station's signal, but must negotiate with the local broadcast station if they decide to carry the broadcast station's signal.

Broadcasters and cable operators negotiate retransmission consent agreements under rules established by the FCC. The outcome of such bargaining may result in a complex agreement. Cable operators often choose to provide alternative consideration such as carriage of cable networks that are affiliated with the broadcaster in lieu of cash payment. Because the details of each negotiation vary from one cable operator to another, and because the specific details of these agreements are generally confidential, a market price for retransmission consent rights is not transparent.

The Walt Disney Company requested us to examine two related questions arising from these circumstances. First, what is the relationship between a cash payment that a cable operator might pay for retransmission consent rights and the terms of alternative arrangements to which a local broadcast station owner and a cable operator might agree? As the next section explains, there are several ways that a local broadcast station owner that is affiliated with a cable network or cable networks can be compensated for retransmission consent rights. Second, since the market price for retransmission consent rights is not transparent, what is the estimated fair market price for the retransmission consent rights of the ABC Owned Station signals? By fair market price we simply mean the price that would be observed if retransmission consent rights were traded in cash-only transactions. Using only public or third-party data, we take three approaches:

- First, we observe the retail prices currently charged by DirecTV and DISH Network, two leading satellite operators, for their packages of local broadcast signals in each market, and we work backwards to estimate a license fee for the ABC Owned Station signal that is part of that package. Estimates range from $0.97 to $1.23 per subscriber per month.

- Second, we observe the retail price currently charged by a local cable operator in each of the markets for the tier of programming that includes local broadcast station signals, and we again work backwards to estimate a license

fee for the applicable ABC Owned Station signal, which is part of that tier. This estimate ranges from $1.90 to $3.06 per subscriber per month.

- Third, we observe the relationship between what cable operators in general pay in monthly per subscriber license fees for basic cable networks and the value of basic cable networks as measured by what each spends on programming. After adjusting for the ability of the cable operator to generate revenues from local ad availabilities on certain cable networks, we use the license fee/program cost relationship to estimate what the license fee would have been for the selected ABC Owned Station signals in 2003 if they were basic cable networks. That estimate is $2.27 per subscriber per month.

Taking an average of the benchmark estimates for each market yields a fair market valuation of the retransmission rights for the selected ABC Owned Station signals ranging from $2.00 to $2.09 per subscriber per month.

CASH OR CARRIAGE?

Under the retransmission consent rules, cable operators and direct broadcast satellite distributors (collectively, multichannel video programming distributors or "MVPDs") and local broadcast television stations negotiate the terms under which MVPDs will retransmit the applicable television station(s)'s signal(s). Congress created retransmission consent rights as part of the Cable Television Consumer Protection and Competition Act of 1992. When the first transactions concerning these rights were negotiated, leading cable operators insisted that they would make no cash payments to broadcasters and subsequently initiated discussions related to launching new cable networks as possible consideration for retransmission consent rights in lieu of cash payments. Eventually, agreements were reached between the broadcast networks and the major cable operators that provided for the cable operators to carry various new broadcast network-owned cable programming services in return for retransmission consent rights to local broadcast station signals. Today, cable operators carrying cable networks as consideration for retransmission consent rights is a common practice. The FCC noted this practice in a 2000 order, and also observed that the practice is presumptively lawful.[2]

According to ABC officials, ABC offers cable systems the right to retransmit the signals of its owned stations for approximately $0.70 to $0.80 per subscriber per month. Cable operators usually decline ABC's cash offer and instead negotiate a customized deal that compensates ABC while meeting the operators' particular needs. We understand that ABC is open to any options that provide ABC with fair consideration for its owned station signals, and ABC works with cable operators to determine what form that consideration may take if the cash option is not accepted by the cable operators.

To illustrate, the following are some of the alternatives ABC has used in order to address the particular circumstances of individual operators: (a) a cable operator may

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2 FCC, First Report and Order, In the Matter of Implementation of the Satellite Home Viewer Improvement Act of 1999 and Retransmission Consent Issues: Good Faith Negotiation and Exclusivity, CS Docket No. 99-363, released March 16, 2000, ¶ 56, point 3.

agree to launch or reposition a cable network to reach more subscribers; (b) a cable operator could extend the term of an existing cable network distribution agreement; and (c) if a cable operator faces capacity constraints in a cable system within an ABC Owned Station's DMA, the operator may agree to launch a cable network outside of the applicable DMA. From an economic perspective, the opportunity to transact in a variety of "currencies" may increase the potential gains to the two parties from a transaction, but it does not alter the parties' respective shares of the gains. Under the various options that ABC offers to cable operators, ABC simply attempts to obtain consideration comparable to the cash option.

ESTIMATED FAIR MARKET PRICE

Using DirecTV and DISH Network prices as a benchmark

DirecTV and DISH Network are the two major direct broadcast satellite (DBS) providers in the United States, with a current combined total of over twenty million subscribers. Legislation enacted in 1999 gave DirecTV and DISH Network the right to carry local broadcast stations. Both companies compete with cable television operators for subscribers, and both carry many of the same networks as cable systems. We therefore assume that DirecTV and DISH Network subscribers are representative of cable subscribers in their valuation of local broadcast signals, and that the relationship between wholesale and retail prices for such programming on DirecTV and DISH Network is indicative of the corresponding relationship for cable systems, and vice versa.

Any subscriber to DirecTV in a market where DirecTV provides local signals can add a package of local broadcast channels for $6.00 per month.[3] DirecTV currently offers such local programming in Philadelphia and Flint.[4] A subscriber to DISH Network in those markets with a local signal package can add the package for $5.99 per month. DISH Network also currently offers a local programming package in Philadelphia and Flint. Given the competitive importance to DBS services of offering local channels, DBS providers may provide these packages at reduced rates to spur subscribership.[5] If so, our estimates based on this benchmark will understate the fair market value of retransmission rights.

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3 Beginning in March 2004, if a subscriber purchases a DirecTV package with local channels, the subscriber gets a $3 bundling discount. But if the subscriber only had Select Choice or some kind of special package or a complimentary package, and wanted to add the local channels, then the additional cost would be $6. See copy of a June 2004 DirecTV monthly statement attached as Appendix A.

4 DirecTV plans to begin offering local signals in Toledo in 2004.

5 The FCC noted that the growth in DBS subscribers is, in part, attributable to the authority granted to them to distribute local broadcast television stations. FCC, *Tenth Annual Report: Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, MB Docket 03-172, ¶¶8, 65.

In each market, both the DirecTV and DISH Network packages include programming from several local stations. It is unlikely, however, that the signals have equal value, either to subscribers or to DirecTV or DISH Network in attracting subscribers. For purposes of our analysis we assume that the value of the stations included in either the DirecTV or DISH Network local package is proportional to the stations' shares of local audience.[6] Using data from the May 2004 sweeps, we determine the total day viewing share of each programming service included in each market's local channel package.[7] We then compute each ABC Owned Station signal's share of viewing relative to all services in the package.

We attribute to each ABC Owned Station signal a percentage of the retail value of the local channel package based on its relative share of viewing of services in the package. The results are presented in Table 1. The implied retail value for an ABC Owned Station signal ranges from $1.64 to $2.08 based on the DISH Network price and from $1.65 to $2.09 based on the DirecTV price.

Table 1: Estimated retail value of ABC Owned Station signals based on DBS fees

	DISH Network ($5.99/mo.)		DirecTV ($6.00/mo.)	
Market	ABC Owned Station Viewing Share	Attributed Value	ABC Owned Station Viewing Share	Attributed Value
Flint	34.8%	$2.08	34.8%	$2.09
Philadelphia	27.5%	$1.64	27.5%	$1.65
Toledo	n.a.	n.a.	n.a.	n.a.

To derive an estimate of market value for local broadcast retransmission rights, we need to translate this retail value into a corresponding wholesale value or license fee.

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6 Viewers' demand or willingness to pay for programming is not the same as ratings or viewing shares. In theory, programming with a relatively small audience that is intensely interested may command higher revenue than programming that attracts a larger but less interested audience. Lacking direct measures of viewer willingness to pay for individual broadcast networks, we use ratings and viewing shares as an approximation.

7 Underlying data are from Nielsen.

To do this, we make use of the relationship between wholesale license fees and subscriber prices observed for other programming. In 2002, wholesale revenue for premium services was about 59 percent of retail revenue for such services.[8] Applying this percentage implies that the wholesale value to ABC Owned Station signals would range from $0.97 to $1.23, based on both the DISH Network prices and the DirecTV prices. See Table 2. This percentage is equivalent to a retail markup over wholesale of about 70 percent. Since DBS providers would likely apply a very low or no markup to the license fee given the competitive importance of local signals to DBS services, as noted above, the actual retail markup may well be lower than 70 percent and therefore the wholesale values are likely to be higher than estimated here.

Table 2: Estimated wholesale value of ABC Owned Station signals based on DBS fees

Market	DISH Network	DirecTV
Flint	$1.23	$1.23
Philadelphia	$0.97	$0.97
Toledo	n.a.	n.a.

Using the local cable operator's basic tier price as a benchmark

Our second approach to estimating a fair market value for retransmission of the ABC Owned Station signals is to look at the retail price a local cable operator charges for the service tier that includes the ABC broadcast station and then work backwards to an implied wholesale value.[9]

Most cable operators provide a Basic Service Tier that functions primarily as a "reception" package. The tier is typically composed of local broadcast television stations and government access channels. Most likely, as with the satellite local signal packages, this price is below fair market value. Although some cable television prices have recently

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8 Kagan World Media, *The Pay TV Newsletter*, July 31, 2002, p. 3. Kagan estimated that the wholesale percentage of retail revenue was 59.1 percent in 2002 and would be about 59.5 percent in 2004.

9 The cable operators selected were identified as serving the named city.