BEFORE THE

Federal Communications Commission

WASHINGTON, D.C.

In the Matter of	)	
	)	
The Commission's Cable Horizontal and Vertical Ownership Limits	)	MM Docket No. 92-264
	)	

REPLY COMMENTS OF COMCAST CORPORATION

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Comcast Corporation ("Comcast") hereby files reply comments in the above-captioned proceeding (the "*Second Further Notice*").[1]

I. INTRODUCTION AND SUMMARY

For over a decade, the Commission has been attempting to adopt cable ownership rules pursuant to Section 613(f) of the 1992 Cable Act.[2] The goal has proven difficult and elusive. In response to the Commission's initial efforts, the court in *Time Warner II* found "that the horizontal and vertical ownership limits unduly burdened cable operators' First Amendment rights, that the Commission's evidentiary basis for imposing the ownership limits . . . did not meet the applicable standards of review, and that the Commission had failed to consider sufficiently changes that have occurred in the MVPD market since passage of the 1992 Act."[3]

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1 *In re The Commission's Cable Horizontal and Vertical Ownership Limits*, Second Further Notice of Proposed Rulemaking, 20 FCC Rcd. 9374 (2005) ("*Second Further Notice*").

2 47 U.S.C. § 533(f).

3 *Second Further Notice* ¶ 6 (citing *Time Warner Entm't Co. v. FCC*, 240 F.3d 1126, 1130-40 (D.C. Cir. 2001) ("*Time Warner II*")).

In response to *Time Warner II*, the Commission issued the *2001 Further Notice* to "solicit[] comment on the nature of the MVPD industry, industry changes since the 1992 Cable Act, how these changes affected the implementation of horizontal and vertical limits, and various proposals for a new horizontal limit."[4] Commenters offered a variety of ownership proposals, but the Commission concluded that "none of the comments yielded a sound evidentiary basis for setting horizontal or vertical limits as demanded by the D.C. Circuit."[5] Accordingly, the Commission issued the *Second Further Notice* in order "to update the record and provide additional input on horizontal and vertical ownership limits so that [the Commission] may comply with [its] statutory mandate and the court's directive in *Time Warner II*."[6]

The challenge remains. The comments filed in the *Second Further Notice* put the Commission in no better position to justify a horizontal ownership limit than when it first attempted to do so in 1993, or when it tried again in 1998. In fact, the record in the *Second Further Notice* is considerably weaker than the records upon which the Commission has previously failed to justify a cable ownership limit because marketplace facts today demonstrate more than ever that such a limit is unnecessary and cannot withstand judicial scrutiny. Consider, for example, the following:

- Although the primary rationale underlying Section 613(f) is to ensure that cable operators do not impede the flow of programming to consumers, only *one* would-be programmer, The America Channel ("TAC"), filed comments arguing that such a rule is needed. After failing to obtain carriage agreements during the past two years from virtually every MVPD -- small cable operators, large cable

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4 *Id.* ¶ 7 (citing *In re Implementation of Section 11 of the Cable Television Consumer Protection & Competition Act of 1992*, 16 FCC Rcd. 17,312 (2001) ("*2001 Further Notice*")).

5 *Id.* ¶¶ 9, 63.

6 *Id.* ¶ 16.

operators, and DBS operators, alike -- TAC tries to lay the blame for its carriage problems on the size of the two largest cable operators.[7] As explained below, TAC's comments are entirely without merit and do not justify imposition of any cable ownership limit.

- Similarly, only one cable competitor, DIRECTV, filed comments, and its comments highlight that company's strong competitive position in the marketplace and *reject* the need for a cable ownership limit.[8] Comcast and NCTA provided extensive evidence of marketplace competition that supports the conclusion that cable ownership limits are unnecessary, which is reinforced by DIRECTV's filing. No party submitted contrary evidence, nor could they, given the state of today's video programming marketplace.[9]

- Although numerous, duplicative form e-mails were filed in response to a campaign orchestrated by Free Press, these e-mails provide no evidence of competitive harms and largely raise questions not at issue in this proceeding (*e.g.*, cable rates, customer service, and program bundling). As explained below, to the extent the e-mails raise concerns about diversity in media or programming, the concerns do not apply in the context of cable system ownership. In fact, cable companies facilitate diversity in programming.

- The record contains no meaningful economic theory or evidence to support a cable ownership limit. The Communications Workers of America ("CWA"), two professors, and a graduate student filed economic analyses they claim support an ownership limit.[10] However, as discussed below and in the attached critique

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[7] *See* The America Channel Comments at 51 (Aug. 8, 2005) ("TAC Comments"). In addition to TAC, only two commenters (other than the e-mail campaign orchestrated by Free Press, an entity that filed one of the comments) urged the Commission to adopt an ownership limit. *See* Communications Workers of Am. Comments at 1, 12-13 (Aug. 8, 2005) ("CWA Comments"); Consumer Fed'n of Am. et al. Comments at 4-5, 68-70 (Aug. 8, 2005) ("CFA Comments").

[8] *See* DIRECTV Comments at 1, 6-10 (Aug. 8, 2005).

[9] *See* Comcast Comments at 16-35 (Aug. 8, 2005); NCTA Comments at 7-12 (Aug. 8, 2005).

[10] *See* CWA Comments Attachment 1 (William G. Shepherd, Economic Policy Institute, *Basic Economics: The FCC Should Set a 30% Limit on Cable TV Market Shares* (2005) ("*CWA Working Paper*")); Chen, Kang & Waterman Letter (Aug. 8, 2005) (attaching David Waterman, *Local Monopsony and Free Riders*, Info. Econ. & Pol'y (vol. 8 1996); Jun-Seok Kang, Dep't of Telecomm., Indiana Univ., *Reciprocal Carriage of Vertically Integrated Cable Networks: An Empirical Study* (July 28, 2005) (unpublished manuscript); Dong Chen & David Waterman, Dep't of Econ., Peking Univ., Dep't of Telecomm., Indiana Univ., *Vertical Foreclosure in the U.S. Cable Television Market: An Empirical Study of Program Network Carriage and Positioning* (Aug. 7, 2005) (unpublished manuscript)).

prepared by Janusz A. Ordover and Richard Higgins ("*Ordover Analysis*"),[11] all of these analyses suffer from serious methodological flaws, misconstrue marketplace realities in order to prop up their theories, and fail to provide any direct evidence of competitive harms.

In the 13 years since Congress instructed the Commission to consider a cable ownership limit, advocates have yet to submit evidence that a limit is necessary or justifiable. The record in response to the *Second Further Notice* is no different. Just as they did in the *2001 Further Notice*, commenters presented "theoretical, legal or economic arguments and anecdotal evidence, [and] no party provided a compelling approach that supported a particular horizontal or vertical limit" that would meet the standards of *Time Warner II*.[12]

II. PROPONENTS OF A CABLE OWNERSHIP LIMIT HAVE ONCE AGAIN FAILED TO PROVIDE ANY EVIDENCE THAT SUCH A LIMIT IS JUSTIFIED IN THE CURRENT MARKETPLACE.

The comments filed in the *Second Further Notice* cannot possibly justify a cable ownership limit that would satisfy the requirements of *Time Warner II*. In particular, *Time Warner II* requires that any cable ownership limit be based on evidence that there is a "real" and "non-conjectural" risk that cable operators will engage in harmful anti-competitive behavior by abusing market power over programmers -- and thereby impede the flow of programming to consumers.[13] The record provides no such evidence. In fact, the record shows just the opposite: consumers today have numerous and growing choices for obtaining their video programming, and program producers have more options than ever for distributing their programming.

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11 *See* Janusz A. Ordover & Richard Higgins, *Critique of Economic Submissions Filed in the Federal Communications Commission's ("FCC")* Second Further Notice *in the Cable Horizontal Ownership Proceeding* (Sept. 23, 2005) ("*Ordover Analysis*") (attached as Exhibit 1).

12 *Second Further Notice* ¶ 9.

13 *Time Warner II*, 240 F.3d at 1132.

A. The Almost Total Absence of Comments by Programmers Demonstrates That There Is No Evidence of Harm to the Programming Industry That Could Justify a Cable Ownership Limit.

The Commission has acknowledged that the "primary purpose of the cable horizontal ownership rules is to ensure that the flow of video programming to consumers not be unfairly impeded by cable operators."[14] Yet despite ample time and publicity about this proceeding, *only one* "programmer," TAC, filed comments. This is a clear indication that programmers do not believe that horizontal or vertical cable ownership rules are necessary to ensure the flow of video programming to consumers.[15]

As mentioned above, TAC is a prospective programmer that has been attempting to develop a network for the past four years and has been seeking carriage agreements for the past two years.[16] TAC has had difficulty obtaining carriage agreements from *all* MVPDs, including large and small cable operators, DBS companies, and others. To Comcast's knowledge, TAC has only been able to obtain carriage from one cable operator serving approximately 150,000

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[14] *Second Further Notice* ¶ 82; *see* 47 U.S.C. § 533(f)(2)(A).

[15] In the past, certain parties have claimed that programmers do not file in favor of a cable ownership limit out of fear of retaliation from cable operators. This claim is pure conjecture and is undermined by marketplace facts. Many programmers are part of large, well-funded corporations, such as Disney and Fox, that have not hesitated to challenge cable operators when it is in their self-interest. *See e.g.*, *In re Time Warner Cable, Emergency Petition of ABC, Inc. for Declaratory Ruling and Enforcement Order for Violation of Section 76.58 of the Commission's Rules*, Petition, CSR-5543-C (May 1, 2000) (requesting that the Commission require Time Warner to carry ABC broadcast stations through a sweeps period); John M. Higgins, *Cox, Fox Settle Sports Fight*, Broad. & Cable, Dec. 4, 2003 ("Despite the companies' shouting match over license fees, Fox Sports secured a six-year renewal of its carriage deal with Cox Communications that includes retransmission consent of Fox Broadcasting stations."). Even independent programmers have not been afraid to challenge cable operators publicly where they believe it is necessary to protect their interests. *See* R. Thomas Umstead, *Time for Hardball? YES Says Yes,* Multichannel News (Mar. 11, 2002) (describing YES Network's efforts to gain carriage on Cablevision cable systems).

[16] *See* TAC Comments at 10; The America Channel, LLC, *Programming* (listing "a few examples of the shows *planned* for The America Channel" (emphasis added)), *at* http://www.americachannel.us/programming.php (last visited Sept.. 22, 2005).

subscribers and, recently, a telephone company that has yet to begin offering video service.[17] TAC's problems with obtaining carriage plainly are not related to the size of any particular cable operator.

TAC claims that an ownership limit is needed because cable operators such as Comcast and Time Warner are able to act individually to prevent an independent network from reaching enough subscribers to remain viable. TAC claims that "carriage by Comcast and Time Warner is required for a network to reach even 25 million subscribers, despite the availability of other MVPDs in the marketplace."[18] TAC bases these conclusions on an analysis of 92 networks that reach over 25 million subscribers. TAC asserts that of these 92 networks, 90 are carried by either Comcast or Time Warner, which leads TAC to the conclusion that were it not for Comcast and Time Warner agreeing to carry a network, other MVPDs would have refused to carry the network. This is illogical.

TAC provides no evidence whatsoever for the proposition that a decision by Comcast or Time Warner in effect controls the decisions of all the other MVPDs, including DIRECTV and EchoStar, which collectively serve over 26 million subscribers.[19] A better explanation for

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17 *See America Channel Secures Analog Carriage Deal*, Orlando Bus. J., Nov. 17, 2003, *available at* http://www.bizjournals.com/orlando/stories/2003/11/17/daily7.html; Press Release, Verizon Communications Inc., *Verizon Signs 5 Additional Programming Deals for Verizon FiOS TV* (Aug. 29, 2005) (reporting that Verizon has agreed to distribute TAC to some unidentified number of its future FiOS TV customers when it launches its service later this year).

18 TAC Comments at 19.

19 *See* Press Release, The DIRECTV Group, Inc., *The DIRECTV Group Announces Second Quarter 2005 Results* (Aug. 4, 2005) ("*DIRECTV 2Q05 Release*") (reporting 14.67 million subscribers as of June 30, 2005), *available at* http://phx.corporate-ir.net/phoenix.zhtml?c=127160&p=irol-newsArticle&ID=739619&highlight=; Press Release, EchoStar Communications Corp., *EchoStar Reports Second Quarter 2005 Financial Results* (Aug. 9, 2005) ("*EchoStar 2Q Release*") (reporting 11.46 million subscribers as of June 30, 2005), *available at* http://www.corporate-ir.net/ireye/ir_site.zhtml?ticker=dish&script=410&layout=-6&item_id=741012. The *Time Warner II* court expressly noted that the "*availability*" of DBS provides a powerful constraint on the ability and

(footnote continued…)

TAC's "evidence" is that the programming networks that have reached 25 million subscribers produced programming that many MVPDs, including Comcast and/or Time Warner, consider valuable to consumers.[20] TAC's argument is also weakened by the fact that there are numerous examples of programming services that obtained most of their initial carriage on DBS.[21]

The fact is that Comcast and other MVPDs consider numerous factors in making carriage decisions, including the content and theme of the network, the necessity or desirability of its presentation as a linear network, the financing of the network, the experience and proven capability of the management team to effectuate the vision, the distribution secured by the network elsewhere, and the fees and terms of carriage. In Comcast's view, and apparently the view of almost every other MVPD, TAC has not demonstrated that it meets these criteria. For example, TAC has yet to produce a single hour of programming, let alone enough programming to sustain an entire network, that Comcast can review to determine whether its customers will value TAC's programming.[22] In addition, TAC has virtually no in-house programming expertise and no reliable source of funding to produce the programming it intends to provide. TAC's

(…footnote continued)

incentive of cable operators to unfairly impede video programming. *See Time Warner II*, 240 F.3d at 1134 (noting that "it seems clear that in revisiting the horizontal rules the Commission will have to take account of the impact of DBS on [cable operators'] market power").

20 *See* Reply Comments of Adelphia, Time Warner, and Comcast, filed in MB Dkt. No. 05-192, at 38 (Aug. 5, 2005) ("*Comcast Adelphia Reply*") ("It is absurd to suggest that there is something nefarious about the fact that two experienced cable operators, with a proven ability to meet consumer demand, are capable of recognizing the quality, value and potential of any particular network, or that they would each independently decline carriage of an unproven, and indeed non-existent, network such as TAC.").

21 *See* Comcast Comments at 79 (listing BBC America, CNBC World, Bloomberg Television, ESPN U, Classic Sports/ESPN Classic, GolTV, DIY, Boomerang, The Independent Film Channel, and NFL Network).

22 Although TAC announced in January 2004 it had signed an agreement with Greystone Television & Films to jointly produce and develop programming, TAC has not yet provided to Comcast any programming that has been produced.

inability to secure carriage reflects deficiencies in its own business plan, not unfair treatment by a particular MVPD or a structural problem in the industry.[23]

B. The Record Clearly Demonstrates That No Cable Ownership Limit Is Necessary or Could Be Justified Under *Time Warner II* in the Current Marketplace.

DIRECTV is the only cable competitor that filed comments, and it argued *against* cable ownership limits, either on a national or a regional basis.[24] DIRECTV states that it has "sufficient national market share to negotiate on an equal footing with distributors such as Comcast and Time Warner."[25] In other words, DIRECTV offers programmers a viable

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[23] Comcast offered to allow TAC to demonstrate the value of its programming concept on Comcast's video-on-demand ("VOD") platform. TAC declined this offer. In its comments, TAC asserts that VOD carriage is not a viable alternative to linear carriage because it is "unproven." TAC Comments at 46. However, it has been Comcast's experience that VOD content offerings are rapidly gaining in popularity. For example, Comcast's customers watched 125 million VOD streams in August of 2005 and by the end of 2005 that number will likely be up to 200 million per month. *See* John M. Higgins, *Empty Screens*, Broad. & Cable, Sept. 19, 2005 (quoting Comcast President Steve Burke). Moreover, the strong consumer response to VOD is fueling the development of new technologies for measuring demand for VOD content, which will provide the "measurement data required to capitalize on advertising opportunities and develop practical VOD business models." Joel Meyer, *VOD Software To Include Nielsen Codes*, Broad. & Cable, Aug. 17, 2005 (internal quotations omitted), *available at* http://www.broadcastingcable.com/article/CA635703.html; *see* Ken Kerschbaumer, *Tracking Video-on-Demand*, Broad. & Cable, Aug. 22, 2005 (highlighting Rentrak OnDemand Essentials measurement system for measuring VOD viewership), *available at* http://www.broadcastingcable.com/article/CA6249802.html. In short, VOD is a useful way for a would-be programmer such as TAC to demonstrate the appeal of its programming and thereby strengthen its case for further distribution by cable operators and other MVPDs. *See* Elizabeth Birch, *We Have Our Own Networks. Get Used to It*, Broad. & Cable, Aug. 15, 2005, at 30 (noting that Here TV decided to be distributed "over the system as a hybrid premium/video-on-demand service and now has a deal with every major cable provider. It's available in 42 million homes."); *5Qs with C.J. Cutler, CEO, Lime*, CABLEFAX DAILY, Aug. 8, 2005 ("We intend to build [Lime] in satellite, radio, linear, non-linear on demand, VOD, SVOD, wireless, DVD, broadband and Web -- all of those platforms. We're already on air, on demand and on satellite radio and are still building out on the Web.").

[24] DIRECTV's comments primarily focus on regional market considerations; however, they do not support adoption of ownership rules to address these issues.

[25] DIRECTV Comments at 4 (noting that DIRECTV has national market share "comparable to [that] of larger cable operators"); *see also* ACA Comments at 6 (noting that DBS is a substitute for cable). DIRECTV also pointed out that it "now offers national programming packages comparable to those offered by cable operators." DIRECTV Comments at 4.

alternative to cable for distribution of their programming,[26] and, as a result of this and other competitive outlets, no cable operator can impede the ability of any programmer to distribute, or any consumer to receive, the programmer's offering. Under these facts, a cable ownership limit cannot be justified.[27]

Furthermore, Comcast and NCTA provided strong evidence in their comments that ownership limits are unnecessary. Today, consumers have a vast number of options for obtaining, and program producers and aggregators have an equally large and effective number of options for distributing, video programming.[28] Advocates of cable ownership limits do not even attempt to address these marketplace facts. As a result, it is difficult to see how the Commission could, consistent with the requirements of *Time Warner II*, find real and non-conjectural evidence that a single cable operator could unfairly impede the flow of video programming sufficient to justify a cable ownership limit.

C. The Duplicative E-Mail Comments Filed in Response to the *Second Further Notice* Provide No Evidence To Justify an Ownership Limit and Raise Concerns About Diversity That Do Not Apply to Cable Operators.

Numerous individuals filed duplicative form e-mails in response to a campaign orchestrated by Free Press. Comcast respects the right of individual citizens to make their views

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26 DIRECTV Comments at 4.

27 To the extent DIRECTV's comments are intended to advocate imposition of conditions on the Commission's approval of the Adelphia transaction, these arguments have been fully rebutted in MB Docket No. 05-192. *See Comcast Adelphia Reply* at 45-61. Comcast will not repeat that rebuttal here, but incorporates it into the record in this proceeding.

28 *See* NCTA Comments at 7-12; Comcast Comments at 16-35. These options include not only cable operators, but also DBS providers, overbuilders, telephone companies, broadcast networks, broadcast station groups and local television stations, national program networks, regional program networks, the Internet, video-on-demand, downloadable video services (like TiVO), through-the-mail services (like Netflix), and mobile telephone "third screen" services.

known to the Commission on this or any other subject. For a number of reasons, however, this type of orchestrated campaign contributes very little to the record and certainly adds nothing that would satisfy the rigorous requirements of *Time Warner II*.

First, the e-mails contain conclusory statements with no attempt to provide any evidence or analysis to support their claims. Second, the objections raised in the e-mails primarily concern issues that are wholly irrelevant to whether an ownership limit is necessary to ensure that cable operators cannot impede the flow of programming to consumers, *e.g.*, cable prices, customer service, the price of cable Internet service, the bundling of programming into tiers, and the "quality of public accountability in local franchise agreements."[29] Such comments do not provide evidence that concentration in the cable industry will impede the flow of programming to consumers, and the e-mails do not even suggest otherwise.[30]

Finally, some of the form e-mails raise concerns about diversity that have previously been raised with regard to broadcast ownership. These concerns are not relevant in the context of the cable industry. Comcast offers its customers hundreds of channels from a wide range of programming networks, and thousands more programming choices on demand. It is in Comcast's business interest to do so because the more diverse its program offerings, the more

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[29] *See, e.g.*, Ann Magdeburger Comments (Aug. 8, 2005), *available at* http://gullfoss2.fcc.gov/prod/ecfs/retrieve.cgi?native_or_pdf=pdf&id_document=6518137955. Some comments were clearly misfiled. *See e.g.*, Marian Meyers Comments (Aug. 8, 2005) (asserting that "LPFM stations provide a valuable serve to those who would otherwise remain voiceless, but they also educate the broader community in ways that are priceless. Please support LPFM stations as the alternative to commercial broadcasting they were meant to be."), *available at* http://gullfoss2.fcc.gov/prod/ecfs/retrieve.cgi?native_or_pdf=pdf&id_document=6518138846.

[30] Comcast notes that the Commission has regulations in place that govern the rates most cable operators may charge for their basic tiers and the customer service requirements a cable operator must follow. *See* 47 C.F.R. §§ 76.901-.990 & 76.309.

effective Comcast will be in attracting customers to its service.[31] Comcast exercises editorial discretion in selecting the networks and services it believes will attract consumers, much like a newspaper chooses which columnists to carry. But once Comcast selects a programming network for its cable service, Comcast exerts little, if any, influence over what content that network transmits or, more importantly, which viewpoints that network expresses. In fact, carriage contracts typically contain a provision that expressly prevents the cable operator from editorializing or inserting content into the network's feed. For these reasons, the type of diversity concerns that some parties have raised in the context of broadcast ownership, whatever their relevance in that context, are not applicable to cable.

In its efforts to find attractive programming to serve the needs and interests of its varied subscribers, Comcast has helped to proliferate diverse programming networks. For example, TV One, a network targeting the African-American community that is majority owned by African-Americans, was created by a partnership between Radio One and Comcast. TV One debuted in January 2004 in the Atlanta, Baltimore, Detroit, Richmond, and Washington, D.C. markets, but since has spread to many other major metropolitan areas.[32] Moreover, when the Haitian-owned and operated cable programming network Haitian Television Network ("HTN") was failing, Comcast made the investment necessary to ensure that HTN's Haitian -oriented offerings would remain on Comcast's South Florida lineup. HTN remains the nation's first and

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31 *See* Comcast Comments at 41, Ex. 1 (Arlington, VA channel line-up).

32 To date, TV One reaches over 22 million households. *See* Press Release, TV One, LLC, *TV One Acquires Award-Winning Drama New York Undercover, Classic Sitcom Amen from NBC Universal Domestic Television Distribution* (Sept. 15, 2005), *available at* http://www.tvoneonline.com/inside_tvone/news_content.asp?ID=1068.

only French/Creole language program channel.[33] In addition, Comcast offers a broad variety of multicultural programming fare targeted to a wide range of viewers.[34]

III. THE MINIMAL ECONOMIC ANALYSES SUBMITTED BY COMMENTERS SUFFER FROM SERIOUS METHODOLOGICAL FLAWS, MISCONSTRUE MARKETPLACE REALITIES IN ORDER TO PROP UP THEIR THEORIES, AND FAIL TO PROVIDE ANY EVIDENCE OF COMPETITIVE HARMS.

CWA and three authors submitted research papers that purport to justify imposition of an ownership limit.[35] All of these papers and their respective conclusions suffer from two significant methodological flaws.

First, each paper relies on the assertion that cable operators have a monopoly in the local market in order to support their respective conclusions.[36] The authors refuse to even contemplate, let alone refute, the notion that other MVPDs compete effectively against cable operators; in the authors' minds, it is as if the marketplace has been in stasis since before 1992 when the cable ownership provision was adopted.[37] But this is certainly not the case; for example, DBS providers have grown from obscurity in 1992 to being the second and third largest MVPDs in the Nation today, collectively serving approximately 28% of all MVPD subscribers

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33 *See generally Haitian Television Network of Am., LLC, HTN, at* http://www.htnsat.com/ (last visited Sept. 21, 2005).

34 *See* Comcast Comments, filed in MB Docket No. 05-255, at 46-47 (Sept. 20, 2005).

35 *See supra* note 10.

36 *See CWA Working Paper* at 1; Kang, *supra* note 10, at 5 ("The critical feature to note about the structure of the cable television industry is that each [cable system operator] is a local monopolist in the franchised area."); Chen & Waterman, *supra* note 10, at 3 (claiming that "cable system operators are typically local monopolists in a given geographic area, creating a bottleneck that gives rise to the potential threat of foreclosure").

37 *See Ordover Analysis* at 6, 9, 18. The Waterman paper's analysis of monopsony power is especially susceptible to criticism for not accounting for the presence of MVPD competition. As the *Ordover Analysis* explains, "Competition between cable and DBS . . . largely eliminates a cable operator's ability to exert monopsony-like power over a content supplier." *Id.* at 9.

nationwide.[38] Nevertheless, CFA and CWA similarly continue to perpetuate the myth that DBS providers serve a niche market of high-end subscribers, are not a direct substitute for cable, and do not compete with cable.[39] Yet, the record in this proceeding -- and DIRECTV's comments in particular -- shows that cable operators compete fiercely with DBS and other MVPDs for every customer.[40] The Commission too has recognized repeatedly the impact of DBS on competition, and expressly rejected claims that DBS does not compete with cable.[41]

Second, all the analyses primarily raise concerns about vertical integration. But the analyses refuse to take into account the fact that vertical integration in cable has steadily *declined* over the past 13 years, and is now less than half of what it was in 1992. At that time, 48% of all national cable programming networks were vertically integrated with a cable operator, while today only 23% of all national cable networks are affiliated with cable operators.[42]

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38 *See DIRECTV 2Q05 Earnings Release*, *supra* note 19; *EchoStar 2Q05 Earnings Release*, *supra* note 19; Kagan Research LLC, *Kagan Media Index*, Kagan Media Money, Aug. 30, 2005, at 8 (reporting 93.5 million MVPD subscribers nationwide).

39 CFA Comments at 57-59; CWA Comments at 13.

40 *See*, *e.g.*, Comcast Comments at 20-22; NCTA Comments at 7-12; *see also* Comcast Comments, filed in MB Docket No. 05-255, at 5-37 (Sept. 20, 2005); Comcast Comments, filed in MB Docket No. 04-207, at 2-6 (July 15, 2004).

41 *See*, *e.g.*, *In re Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Eleventh Annual Report, 20 FCC Rcd. 2755 ¶ 6 (2005) ("*11th Annual Report*") ("[W]e find that consumers today have viable choices in the delivery of video programming, and they are exercising their ability to switch among MVPDs."); *2001 Further Notice* ¶ 22 ("Perhaps the most important difference between the industry in 1992 and today is that in 1992 there was no clear nationwide substitute for cable. Today, on the other hand, DBS has a national footprint. . . . DIRECTV now is the third largest MVPD operator, after AT&T and Time Warner, and EchoStar is the eighth largest." (internal citations omitted)); *Second Further Notice* ¶ 67 ("We observe that DirecTV and EchoStar rank among the top five MVPDs today, and that DBS equipment prices have fallen significantly such that DBS has become more comparable to cable service.").

42 *See 11th Annual Report* App. C, Table 3; NCTA Comments at 4-5. Comcast currently has an interest in nine national networks plus iN DEMAND, which has 35 multiplexed channels of PPV programming. Comcast showed in its comments that the vast majority of programming it carries is unaffiliated. *See* Comcast Comments Ex. 1. Even if Comcast carried each and every programmer affiliated with *any* cable company, the majority of the programming carried on its cable systems would still be comprised of programming that is not affiliated with any

(footnote continued…)

In short, these studies succumb to the same criticism the D.C. Circuit levied against the Commission in *Time Warner II* because they fail to account for changes in the marketplace since 1992 and, in particular, give insufficient weight to the competitive impact of DBS.[43] In addition, each paper contains a host of other flaws and false assumptions about the marketplace that are described in the attached *Ordover Analysis* and are summarized here.

A. David Waterman, Local Monopsony & Free Riders

The Waterman paper presents a theoretical model of bargaining between cable operators and programming networks that concludes that cable operators have greater bargaining power than programming networks, can increase that bargaining power through increased market share, and will use that bargaining power to redistribute rents from content suppliers to distributors.[44] According to Waterman, in theory, this redistribution will cause programmers to exit the

(…footnote continued)

cable company. Opportunities for Comcast to favor its own affiliated programmers are essentially nonexistent because few, if any, independent networks provide programming similar to Comcast's, and those that arguably do (e.g., BET, Outdoor Channel) are valued so highly by consumers that Comcast cannot afford to lose to DIRECTV or EchoStar.

43 *See Time Warner II*, 240 F.3d at 1134 ("Given substantial changes in the cable industry . . . it seems clear that in revisiting the horizontal rules the Commission will have to take account of the impact of DBS on [cable operators'] market power.").

44 *See* Waterman, *supra* note 10, at 339-41; *Ordover Analysis* at 5-6. In the *Second Further Notice*, the Commission expressly sought "comment on the usefulness of the technical analyses contained in bilateral bargaining theory in light of the wide range of results it appears to generate." *Second Further Notice* ¶ 100. Neither the Waterman paper nor any other submission in the record addresses the Commission's concerns about the usefulness of bilateral bargaining theory in justifying an ownership limit. This is not surprising given the "inherent difficulty of collecting sufficient data to apply such theories empirically with sufficient precision." NCTA Comments at 13; *see Ordover Analysis* at 10 n.6 ("Although analyses based on bilateral bargaining theory are useful in some situations, when it comes to dealing with complex negotiations such as programming network carriage negotiations, which involve a large number of variables that affect bargaining decisions, it is often difficult to account for such variables and to obtain empirical verification of the theory being applied.").

industry, which will reduce the number of programs produced and harm consumers because consumers are better off with more programming.[45]

As the *Ordover Analysis* points out, Waterman's model has a number of shortcomings, in addition to the ones described above, that undermine its utility in the cable ownership context.[46]

For example, Waterman's paper is nearly a decade old and, as explained above, the market it analyzes is highly dynamic and has changed significantly since 1996.[47] In addition, Waterman's conclusions are based on a number of false factual assumptions such as: (1) all negotiations between cable operators and programming networks are simultaneous -- in reality, negotiations are on many different timelines, each with its unique dynamics; (2) there is no uncertainty about consumers' demand and demand for all programming is identical, *i.e.*, consumers will always demand more programming regardless of the quality and number of programming networks available to them -- in reality, demand for programming is uncertain and the quality of programming is highly determinative of the level of demand; and (3) bargaining parties have complete information about pricing and bargain over a lump-sum distribution of the profits as opposed to bargaining for per-subscriber license fees -- in reality, pricing information is highly confidential and bargaining often focuses on per-subscriber license fees.[48]

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45 *See* Waterman, *supra* note 10, at 339-341; *Ordover Analysis* at 4-5**.**

46 *See Ordover Analysis* at 6-10.

47 *See id.* at 6 (noting that "the model's usefulness in this proceeding is doubtful if for no other reason than that it is nearly a decade old and the market it purports to model has undergone significant changes in many dimensions").

48 *See id.* at 7-8. Carriage negotiations are complex and often time-consuming; cable operators and programming networks must negotiate over, among other things, license fees, tiering, channel placement, advertising spots, minimum content, and VOD distribution.

Waterman's paper also fails to account for certain marketplace characteristics that, in many ways, protect against "free-riding" -- the ability of an MVPD to demand a low price from a programming network and free-ride on the higher prices paid by other MVPDs -- and "lessen any MVPD buyer's incentive to try to 'squeeze' the programmer."[49] Most importantly, as mentioned above, the presence of DBS provides programming networks with an alternative means of distribution, which permits a network "to walk away from negotiations with a cable operator who is playing tough and strike a deal with a DBS provider, or other MVPD, to reach consumers in the cable operator's service area."[50] In addition, most favored nation clauses ("MFNs") could "provide some protection against myopic exercise of local market power."[51] If one assumes, reasonably, that MFNs are often included in program distribution contracts, then an MVPD that exercises monopsony power to drive its programming price down may effectively be setting a lower price in all markets where the MFN operates. This, in turn, could ultimately reduce the amount and quality of programming produced. Because such a result is not in the MVPD's interest, its incentive to myopically exercise monopsony power is diminished.[52]

In many respects, Waterman's analysis suffers from the same significant weaknesses as the Commission's experimental economics study published in 2002.[53] "Plainly stated, the model

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49 *Id.* at 7.

50 *Id.* at 9. The *Ordover Analysis* also points out that, in light of the presence of DBS, "the programmer can threaten to strike an exclusive deal with a DBS vendor and thus disadvantage the MSO." *Id.*

51 *Id.* at 8.

52 *See id.* at 7-8.

53 Mark Bykowsky et al., Office of Plans & Policy, FCC, *Horizontal Concentration in the Cable Television Industry: An Experimental Analysis*, OPP Working Paper No. 35 (2002).

cannot be said to depict or predict the actual bargaining process."[54] For example, both studies: (1) assume that there is no uncertainty about consumers' demand and, therefore, consumers will demand more programming regardless of quality; (2) assume that demand for programming networks is identical and, thus, a decision to carry a particular programming network has no impact on whether the MVPD gains or loses any subscribers; and (3) suffer from the common problems associated with experimental economics, *i.e.*, the subjects participating in the experiments did not have the requisite level of knowledge and expertise, had limited resources and information to negotiate in a realistic manner, and had limited terms they could negotiate.[55]

In light of the many flaws in the Waterman paper, the *Ordover Analysis* concludes that "Waterman has not presented a cogent theory that suggests national cable concentration adversely impacts on consumer welfare, nor does his model provide any practical guidance about the magnitude of an ownership cap, if any, that would be consistent with good public policy."[56]

B. Jun-Seok Kang, Reciprocal Carriage of Vertically Integrated Cable Networks

The Kang paper, using a "simple game model," purports to show that vertically integrated cable operators are more likely to carry the cable networks of other vertically integrated MSOs than they are to carry independent cable networks.[57] According to Kang, the

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[54] Comments of Comcast Corp. on OPP Working Paper No. 35, filed in CS Docket No. 98-82, at 6 (July 18, 2002).

[55] *See id.* at 10-14; *see also Second Further Notice* ¶¶ 103-104 & n.361.

[56] *Ordover Analysis* at 10. It is important to note that, even with increased concentration in the marketplace over the past decade, the number of programming networks has not declined; instead, the number has increased from 106 national programming networks in 1994 to 390 in 2004. *See* NCTA, *2005 Mid-Year Industry Overview* 17 (July 2005) ("*2005 Mid-Year Industry Overview*"), *available at* http://www.ncta.com/industry_overview/CableMid-YearOverview05FINAL.pdf.

[57] Kang, *supra* note 10, at 5-8.

study "suggests that . . . a vertically integrated MSO has an incentive to carry the cable networks of other MSOs, while expecting other vertically integrated MSOs to also carry its networks."[58] Kang concludes that the findings support the theory of "reciprocal carriage" -- cable operators "tacitly collude" to carry each others' vertically integrated programming networks.[59]

Kang's conclusions, however, are based on *6-year old data* and a data sample that skews the results towards a false positive for finding that cable operators favor affiliated programming networks over independent programming networks. More specifically, Kang's data sample includes 20% more vertically integrated program networks than independent networks.[60] As the *Ordover Analysis* explains, this data sample could yield results that incorrectly attribute carriage decisions to favoritism.[61] In addition, "although Kang appropriately holds some confounding influences constant, he is likely to have omitted several explanatory factors that would help to explain program carriage by MSOs, including timing of launch relative to development of available channel capacity, launch timing as compared to competing programming, and the extent to which programming suits interests of unserved or underserved audiences or niches."[62]

The Kang paper also makes a number of additional questionable assumptions to arrive at its conclusions, including: (1) each of the cable networks it studies "is equally attractive to advertisers and consumers"; (2) the two hypothetical cable operators analyzed have the same

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58 *Id.* at 1.

59 *Id.* at 1, 19.

60 *See Ordover Analysis* at 11.

61 *Id.* at 11-12. In addition to this fundamental methodological flaw, the Kang paper also has potential problems with its econometric analysis because many of the "control" variables are endogenous, *i.e.*, influenced by the dependent variables they are intended to explain. *See id.* at 12 n.7.

62 *Id.* at 12.

costs and revenue structures; (3) "[i]f neither [system operator] carries a cable network, the network cannot be launched"; and (4) collusion is likely because cable system operators are frequently and "repeatedly interacting" with each other to negotiate carriage contracts.[63] These assumptions have no basis in reality -- Kang certainly provides no evidence to support them -- and cannot possibly justify a cable ownership limit under the strict requirements of *Time Warner II*. In *Time Warner II,* the D.C. Circuit expressly rejected the Commission's earlier assumption regarding collusion (precisely because the Commission, as Kang does here, simply assumed that collusion exists without any evidence that it was a real or even likely outcome),[64] and it is not likely to look any more favorably on this conjecture and speculation to justify a new ownership limit.[65]

C. Dong Chen & David Waterman, Vertical Foreclosure in the U.S. Cable Television Market: An Empirical Study of Program Network Carriage and Positioning.

The Chen/Waterman paper purports to show that, when choosing between two networks that provide similar programming, Comcast and Time Warner will favor carrying their affiliated networks and be less likely to also carry unaffiliated networks. The paper looks at four groups of

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63 Kang, *supra* note 10, at 6, 8. As the *Ordover Analysis* points out, "it is noteworthy that Kang does not claim based on his findings that observed cable conduct is anticompetitive; in fact, in his illustrative theoretical example, he assumes that consumer welfare is independent of which network is carried by which cable operator." *Ordover Analysis* at 11.

64 *See Time Warner II*, 240 F.3d at 1130 ("[W]hile collusion is a form of anti-competitive behavior . . . the FCC has not presented the 'substantial evidence' required by *Turner I* and *Turner II* that such collusion has in fact occurred or is likely to occur; so its assumptions are mere conjecture."); *id.* at 1132-33 ("The only justification that the FCC offers in support of its collusion hypothesis is the economic commonplace that, all other things being equal, collusion is less likely when there are more firms. This observation will always be true, . . . but by itself it lends no insight into the question of what the appropriate horizontal limit is." (citations omitted)).

65 *See id.* at 1133 ("*Turner I* demands that the FCC do more than 'simply posit the existence of the disease sought to be cured.' It requires that the FCC draw 'reasonable inferences based on substantial evidence.'" (quoting *Turner Broad. Sys., Inc*., 512 U.S. 622, 664 (1994) (citations omitted)).

programming networks and the carriage of particular vertically integrated and independent rival networks in each group -- outdoor entertainment (OLN and Outdoor Channel ("OC")), cartoons (Cartoon Network and Toon Disney), basic movie services (Turner Classic Movies, American Movie Classics ("AMC"), Fox Movie Network/Channel ("FMC"), and Independent Film Channel ("IFC")), and premium movie-based networks (HBO, Cinemax, Showtime, The Movie Channel, Encore, Starz!, Flix, and Sundance Channel).[66] Chen and Waterman conclude that "[i]n each of the four network groups studied . . . vertically affiliated networks were almost uniformly favored by Comcast, Time Warner, and AT&T [(as the predecessor to Comcast)] in terms of higher carriage and/or more frequent positioning on analog program tiers that are more widely available to consumers."[67]

As an initial matter, "Chen and Waterman necessarily assume that the programming networks they include in the four different groups are equivalent. In reality, they do not offer equivalent programming."[68] For example, it is hard to believe that legitimate qualitative analysis would conclude that HBO and Sundance Channel provide comparable programming; that Turner Classic Movies, American Movie Classics, Fox Movie Channel, and Independent Film Channel offer comparable movies; or that Outdoor Life Network's broad variety of sports programming (including the Tour de France, the America's Cup, motocross racing, skating, skiing, snowboarding, bull-riding, and, in the near future, NHL hockey) is comparable to Outdoor Channel's programming that focuses primarily on fishing, hunting, prospecting, and four-

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66 *See* Chen & Waterman, *supra* note 10, at 11-13 & Table 1.

67 *Id.* at 25.

68 *Ordover Analysis* at 14.

wheeling. Because programming on each channel tends to be unique, cable operators have every incentive to carry the programming they believe will be the most attractive to consumers regardless of whether it is provided by an affiliated or independent network.[69]

"A fundamental problem with the paper is that Chen and Waterman's findings do not support their conclusions."[70] For example, for outdoor entertainment, Chen and Waterman found that Comcast is *no more likely* than other cable operators to carry affiliated OLN on an analog channel, and *no less likely* than other cable companies to carry independent OC on an analog channel.[71] With respect to cartoons, the paper found that Time Warner is more likely than other cable companies to carry *both* its affiliated Cartoon Network *and* the unaffiliated Toon Disney. For basic movies, the paper found that Time Warner is more likely than other cable companies to carry affiliated Turner Classic Movies, but equally likely to carry unaffiliated AMC, FMC, and IFC. And, for premium movie channels, Time Warner was equally likely to carry independent networks in three instances and less likely in the other three. Time Warner was *less* likely than other cable operators to carry HBO on an analog channel, but more likely to carry Cinemax on analog. How Chen and Waterman derive their conclusions from this variety of findings is a mystery. Even accepting their own data, "[i]n light of the[se] results, it is

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69 *See id.* at 14-15 ("This calls into question the validity of Chen and Waterman's conclusions given that the independent networks do not compete with the vertically integrated networks and, therefore, Comcast and Time Warner would have no incentive to favor one network over another for any other reason than the attractiveness of the programming to their customers.").

70 *Id.* at 15.

71 Chen and Waterman's conclusions that Comcast engages in vertical foreclosure is based wholly on an analysis of Comcast's carriage decisions in 2004 with respect to only one of its affiliated networks, OLN. Yet, in 2004, the decision to carry OLN or Outdoor Channel on Comcast's systems in certain markets could have been made by any of four entities that owned those systems -- TCI, MediaOne, AT&T, or Comcast -- in the past five years, the typical term for a carriage contract.

difficult to understand Chen's and Waterman's conclusion" that the carriage patterns analyzed in their study "'are generally consistent with the vertical foreclosure hypothesis as [they] have defined it.'"[72]

The Chen/Waterman paper also purports to show that Comcast and Time Warner favor their vertically integrated programming networks by placing them on an analog tier while placing independent "rival" networks on a digital tier.[73] That conclusion also does not appear to be supported by the paper's findings. As the *Ordover Analysis* explains:

> The authors report the relative likelihood of placement on an analog channel or in a basic tier for 10 independent networks. In one half of these, the vertically integrated MSO treated the independent program network unfavorably relative to their treatment by non-vertically integrated MSOs; for the other five independent program networks, there was no difference in treatment.[74]

Moreover, there is no indication as to how tier placement of programming is at all related to the size of a cable operator. In fact, Chen and Waterman's "search for evidence of vertical foreclosure in terms of channel placement . . . is misguided. As a matter of economic theory, in the absence of price regulation, if a vertically integrated MSO possessed market power as a buyer of programming it would exercise this power through price, not by providing lower quality carriage."[75]

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72 *Ordover Analysis* at 15 (quoting the Chen and Waterman paper).

73 Chen & Waterman, *supra* note 10, at 19-24 & Table 4.

74 *Ordover Analysis* at 16.

75 *Id.*

D. William G. Shepherd, Basic Economics: The FCC Should Set a 30% Limit on Cable TV Market Shares

The *CWA Working Paper* attempts to justify an ownership limit on the grounds that cable prices have risen since 1996 and the industry bundles the programming it offers to consumers.[76] As the *Ordover Analysis* explains, the paper is more of a rant against what Shepherd and CWA view as large increases in cable rates and what they call cable operators' "*peculiar kind of price structures*, involving the packaging of channels,"[77] "than a serious piece of economic analysis."[78] To the extent the paper attempts to present economic conclusions, it narrowly focuses on market share as the determinant of market power, but this focus is misplaced and a proper analysis must consider a number of other factors affecting market power.[79]

As the *Ordover Analysis* explains, market share is a weak indicator of competitive effects and the ability to exercise market power. "One must go beyond simply looking at market shares and consider other factors, which are discussed in the Merger Guidelines."[80] There is no generally accepted market share threshold for determining "dominance," and the "best approach to this issue is to recognize, as done in the classic paper by Landes and Posner, that the correct answer is case specific or, more correctly, market specific."[81] "In the present instance, instead of market power to sell, the issue is buying market power. Here, the analog of the Landes-Posner

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76 *CWA Working Paper* at 3-5.

77 *Id.* (emphasis in original).

78 *Ordover Analysis* at 17.

79 *See id.* at 18-20.

80 *Id.* at 18.

81 *Id.* at 19

‘residual demand’ formula would look to the overall elasticity of programming supply, the hypothetical dominant firm share of purchases, and the elasticity of demand for programming by MVPD rivals.”[82]

Given the status of these factors in today’s marketplace, especially the presence of two strong DBS competitors, it is clear that, barring a single cable operator comprising the entire side of the buying market, cable market share is at most a minor factor in evaluating market power in the MVPD market.[83] This is precisely the point the court in *Time Warner II* emphasized: “[N]ormally a company’s ability to exercise market power depends not only on its share of the market, but also on the elasticities of supply and demand, which in turn are determined by the *availability* of competition.”[84]

Moreover, even assuming the paper’s economic arguments were sound, it is filled with false assumptions and conclusions. For example, the paper does not explain how a horizontal ownership limit would affect cable prices or change the practice of bundling programming. Significantly, the paper does not establish a correlation between the size of any single cable operator and prices or program bundling; rather, the paper attributes high prices and program bundling to the industry as a whole, including both cable operators who have increased their concentration and those who have not.[85] The failure to establish a size/price correlation undermines any argument that the size of any single cable company has anything to do with the

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82 *Id.*

83 *Id.* at 18-20.

84 *Time Warner II*, 240 F.3d at 1134 (emphasis in original).

85 *Ordover Analysis* at 17-18.

increase in cable rates or the practice of program bundling.[86] And, of course, since virtually all MVPDs (small cable operators as well as large, both national DBS operators, overbuilders, SMATVs, etc.) bundle their program offerings, it is impossible to attribute bundling -- even if it were an anti-consumer practice, which it is not -- to the size of any single cable operator.

The *CWA Working Paper* is little more than a series of unsupported allegations and pieced-together citations to outdated articles (the majority being from the early 1990s, and many being from the 1980s or earlier). It parrots the same irrelevant allegations and conclusions about cable rates, bundling, and market power that are repeated by certain so-called "consumer groups" in virtually every cable-related proceeding, but never supported by evidence.[87] Such conjecture cannot possibly support a cable ownership limit consistent with the requirements of *Time Warner II*.

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[86] The paper also completely ignores the evidence that bundling of programming has substantial benefits to programming networks and consumers, and were it not for bundling, consumers would have less programming and pay higher rates. *See id.* Comcast notes that the Commission, in its *A La Carte Report*, found that "[i]n addition to the benefit bundling confers on the diversity of programming, it also appears to promote fiercer competition between MVPDs." Media Bureau, FCC, *Report on the Packaging and Sale of Video Programming Services to the Public* 23 (Nov. 18, 2004).

[87] *See* CFA Comments at 18-36. CFA once again uses this proceeding to vent about the litany of issues it claims all stem from cable concentration: cable rate increases, program bundling, terrestrial delivery of programming, discrimination in carriage, etc. CFA, however, provides nothing more for the Commission to base an ownership limit on than the rhetoric and assumptions about the marketplace that it has been perpetuating in this proceeding since 1993, but that the *Time Warner II* court already rejected. *See generally* Comments of CFA, filed in MB Docket No. 92-264 (Feb 9, 1993); *see also* Reply Comments of CFA, filed in MB Docket No. 98-82 (Feb. 19, 2002).

IV. CONCLUSION

For the foregoing reasons, it is clear that the comments filed in response to the *Second Further Notice* have done nothing to assist the Commission in justifying a sustainable ownership limit. We respectfully suggest that the record cannot support the imposition of new horizontal or vertical ownership limitations on cable companies.

Respectfully submitted,

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September 23, 2005

EXHIBIT 1

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

Critique of Economic Submissions Filed In the
Federal Communications Commission's ("FCC") ***Second Further Notice***
In the Cable Horizontal Ownership Proceeding

DECLARATION
Of

JANUSZ A. ORDOVER
And

RICHARD HIGGINS

September 23, 2005

We have reviewed the various economic submissions in the *Second Further Notice.*[1] These submissions purport to provide economic rationales for imposing a horizontal limit on cable ownership. Indeed, some commenters argue that even the previous 30% limit was already harmful to social welfare. Based on our review of these submissions, our overarching conclusion is that they fail to make the case for adopting any ownership limit, and certainly do not support a limit more stringent than the previous one. The paramount reason for our conclusion is that (besides being based on rather simple economic models or no economic models) they are not well-grounded in the economic and business realities of today's MVPD sector.

We have been asked by counsel for Comcast to review each of the submissions by economists in response to the *Second Further Notice* and to render our opinion about their relevance to the issues surrounding mandatory ownership caps for MVPDs. Below, for each submission, we provide a brief summary of the underlying methodology and key conclusions, and then we critique its applicability to an analysis of the competitive effects of caps on horizontal cable ownership.

I. David Waterman, "Local Monopsony and Free Riders," *Information Economics and Policy* (1996)

<u>Summary</u>

Of all the papers under consideration, Waterman's article presents the most developed economic model of the provision of cable programming to MVPDs that could be used to assess the economic consequences of increased concentration at the MVPD level. Waterman considers whether increased MVPD concentration increases the ability

[1] *In re The Commission's Cable Horizontal and Vertical Ownership Limits,* Second Further Notice of Proposed Rulemaking, 20 FCC Rcd. 9374 (2005) ("*Second Further Notice*").

and incentives of some (or all) MVPDs to refrain from contributing their "fair share" towards the recovery of programming costs. Waterman finds that increased MVPD concentration increases such incentives. Moreover, if such incentives are significant, they will potentially result in undersupply of programming because content suppliers will exit (or never enter) a market if they cannot recover their costs.[2] From this perspective, "myopic" decisions of each MVPD about how much to contribute to the cost of programming lead to an aggregate undersupply of programming (at least in some situations) since each MVPD incorrectly expects that other MVPDs will contribute enough to pay for the desirable programming. As we shall demonstrate, while this result cannot be faulted as a matter of *theory* within the four corners of the model, its applicability to the public policy question of horizontal caps is rather limited.

Waterman's analysis uses a simple model of bargaining between MVPD and suppliers of video program networks. The model assumes that there is no competition among distributors of video programming and that cable is the only MVPD technology available in a given footprint; this assumption that there is no competition among distributors of video programming is quite important to the results. Waterman also assumes that there are no per-subscriber license fees for programming; instead, the cable operator and the programming network bargain over a lump-sum distribution of the profits associated with the carriage of the programming network. This assumption normally would bias the analysis against the finding of undersupply of programming since, in principle, such bargaining aligns the interest of the operator and programmer.

[2] The basic idea is deceptively simple. For example, suppose that we start by assuming that programmers get 5 percent of MVPDs' profits, and assume that this share is just sufficient to pay for the fixed costs of each program. Now assume that one MVPD decides to pay less than that. This will make some programs not viable, causing exit. Since profit per program will now increase, the remaining programs will then cover costs.

However, in Waterman's model, the bargaining takes place simultaneously and once and for all between programmers and distributors without price discrimination.

The major claimed analytical innovation of the Waterman paper is that monopsony is not merely the "flipside" of monopoly in his model. In a "monopoly" case, a downward-sloping demand curve is required for the monopolist or a cartel to elevate the price of the commodity in question. In other words, if the supply of a good is restricted through cartel activity, the price of the good will increase and so will the profits relative to the competitive level despite lower sales. In a standard monopsony case, an upward-sloping supply curve of the input (say nursing services) is required for a buyer with market power (or a buyer cartel) to find it profitable to depress the price of the input below the competitive level by restricting the amount purchased. In other words, in order to increase the supply of nurses, a buyer (say a hospital) must pay a higher price for nursing staff. If the hospital has market power (for example, it is the only hospital in town) and refuses to pay its nurses a competitive price, then the number of people entering the nursing field will decrease and the remaining ones will agree to work at below-competitive wages.

Waterman argues that even if the supply of programming is perfectly elastic (in the sense that each additional program or "channel" can be produced at the same fixed costs) under some circumstances a "local" monopoly distributor may use its position to extract below-competitive terms from programmers thereby causing the equilibrium number of programming networks to fall below the efficient one. Thus, in his model, the fact that programming is non-rivalrous and the private bargain struck by one video programming licensee has no implications for the "prices" paid by other licensees, is irrelevant to his model's results. In his model, monopsony power is revealed in the failure of an MVPD who bargains over the profit split it is willing to pay for a programming network to consider the full impact of its individual bargaining decisions on the incentive for programmers to enter the programming business. There is a negative externality that individual cable operators exercising market power impose on each other and on "price-taking" MVPDs, which has the effect of reducing the number of video programs available.

For example, assume that a content supplier needs $100 to provide the content. Each MVPD would like to contribute as little as possible to defraying $100, as long as the program will become available. So, if a given MVPD knows that the remaining MVPDs will be willing to pay $95 in the aggregate, the MVPD will try to pay $5 because its decision will not affect availability of the programming network. Where the MVPD is a local monopolist, as Waterman assumes all cable operators are, a content provider will be willing to accept any contribution above his reservation price (i.e., the lowest price at which a supplier is willing to supply any amount of a good). In Waterman's bargaining model the percentage split of programming rents that results depends on concentration on the two sides of the market and, in general, leaves some profit for the content providers in excess of their reservation price. However, as the number of channels provided increases, the marginal profit declines and, at some point, the fixed cost of an additional programming network would outweigh the share of downstream profits on a larger base of programming networks. At this point, program development stops.

The principal conclusions of Waterman's theoretical model are: (1) cable operators' bargaining power is higher the more concentrated the demand side for programming; (2) enhanced bargaining power of individual cable operators has no effect on the prices that viewers pay for programming; instead, it affects the distribution of rents; (3) redistribution of rents from program networks to distributors reduces the number of programs produced; (4) consumers are better off the more programming there is;[3] and, thus, (5) higher cable shares reduce consumer welfare.[4]

Critique of the Waterman Model

There are a number of shortcomings of Waterman's model, which make it inapplicable to the current MVPD marketplace and, therefore, unhelpful in analyzing a cable ownership limit:

First, the model's usefulness in this proceeding is doubtful if for no other reason than that it is nearly a decade old and the market it purports to model has undergone significant changes in many dimensions. In particular, Waterman ignores the presence of competition from DBS and other non-cable MVPDs, including large regional telephone companies. In this 1996 article, Waterman reports that in 1995 non-cable MVPD competition accounted for under nine percent of subscribers; today this figure is more than 28 percent. As explained below, omitting DBS and other non-cable MVPD competitors significantly affects his conclusions.

[3] Of course, this cannot be true for any number of programming choices. If we assume that the marginal value to consumers of additional program declines with the number of programs and that the cost of producing a program is fixed then it has to be the case that the most efficient number of programs is finite.

[4] Waterman equates more programming with more variety in programming, which at one point in his paper he assumes is undersupplied by a monopolist but, which in a later section, he admits may just as likely be over-supplied. More correctly, economic theory alone is not capable of predicting whether monopoly results in too-little, too-much or optimal product quality or variety. (See J. Tirole, *The Theory of Industrial Organization*, MIT Press, 1990, Chapters 2, 7 and 8).

Second, Waterman makes a number of assumptions about the marketplace and market dynamics that are contrary to reality, but which are necessary to support the pro-regulatory actions the article favors. Specifically, the article assumes that all negotiations between cable operators and programming networks are simultaneous, final, and transparent. In reality, such negotiations are staggered, repeated, and confidential. The unrealistic assumption that negotiations are simultaneous is a critical aspect of his model. Without it he could not escape the fact that prices for programming could vary from carrier to carrier and are not common knowledge, which lends credence to a more plausible conclusion that MVPDs cannot profitably exercise traditional monopsony power over video programming. At the same time, the fact that some contracts contain most favored nation clauses ("MFNs") (which give an MVPD the right to any more favorable terms obtained by another MVPD) could act as protection against free-riding and could lessen any MVPD buyer's incentive to try to "squeeze" the programmer.

For example, assume that MFNs are widely available and that an MVPD buyer that bargains down the price by $Y (in fixed payments) will lower the amount that the programmer collects by N*($Y), where N is the number of potential buyers. Then, the buyer who tries to exert local monopsony power in its market effectively exerts monopsony power over all the markets! This undermines the ability to free-ride. Indeed, it is well-known that an MVPD that is a monopolist over all the local markets will in fact procure the jointly profit-maximizing number of programming channels, that is, the number of channels that maximizes joint profits of the MVPD and of the programmer.[5]

[5] In a bargaining model with different assumptions than those in Waterman's paper, Raskovich demonstrates that the larger an MVPD's share the more "pivotal" it becomes as a buyer or funder of video programming and, as a result, larger MVPDs contribute more than their "fair share" to program development in overcoming the free-rider problems associated with competitive bilateral bargaining. (See

This is especially so if the deal between the two sides is based on a fixed payment to each programming network and payments reflect the value of the network. Thus, one could plausibly argue that MFNs provide some protection against myopic exercise of local market power by an MVPD.

Waterman's model also assumes that there is complete information about pricing but, in reality, information regarding carriage contracts is highly confidential and foreknowledge of the success of programming is uncertain. The nature of bargaining assumed in his model is quite different from that found in reality, and its special nature accounts for his apparent ability to obtain results consistent with monopsony. Finally, in his model the profit split between all programmers and all MVPDs is fixed once and for all, and the MVPDs would rather forego profit from the development of additional channels than to revise the fixed division of profits. This latter aspect of his model is critical to obtaining the results he reports and yet is patently unrealistic as a description of negotiations between programmers and even a single distributor of programming. When there is renegotiation, the promise not to pay would be less credible if the program were not produced as a result: for example, suppose that a programmer needs $100 to cover its costs. When the programmer claims to be $10 short, there is a deal that can be struck if not having the program would cost the MVPD more than $10 in profits. Therefore, his paper, while intellectually interesting, does not have practical relevance for the issues in this proceeding.

Ultimately, however, even with his assumption of simultaneous bargaining, his conclusions depend critically on the assumption that cable faces no competition and that

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A. Raskovich, "Pivotal Buyers and Bargaining Power," *DOJ Economic Analysis Group Discussion Paper,* 00-9, 2000).

there are no other sources of income for program creators. In his model, program producers compete—that is, they produce additional programs until there is zero profit associated with program production. In contrast, cable operators face no competition in his model; cable systems earn more or less profit depending on the bargain struck, which in turn depends on cable concentration, but is unaffected by competition from DBS. As a matter of fact, however, there is competition both up- and down-stream.

Competition between cable and DBS limits any MVPD rents cable operators could obtain from subscribers and largely eliminates a cable operator's ability to exert monopsony-like power over a content supplier. Indeed, if a cable MSO refuses to carry programming, or bargains for an advantageous split, the programmer can threaten to strike an exclusive deal with a DBS vendor and thus disadvantage the MSO. With the presence of competition from DBS and other MVPDs in distribution of video programming, content suppliers are not compelled to accept rates, terms, or conditions that will disadvantage their production of programming networks. The content supplier is free to walk away from negotiations with a cable operator who is playing tough and strike a deal with a DBS provider, or other MVPD, to reach consumers in the cable operator's service area. Moreover, given other sources of programmer revenue available in today's marketplace, programmers are less dependent on cable operators to gain the threshold of revenues needed to pay their costs.

In summary, Waterman has not presented a cogent theory that suggests national cable concentration adversely impacts on consumer welfare, nor does his model provide any practical guidance about the magnitude of an ownership cap, if any, that would be consistent with good public policy.[6]

II. Jun-Seok Kang, "Reciprocal Carriage of Vertically Integrated Cable Networks" (July 28, 2005)

<u>Summary</u>

The Kang paper claims to present statistical evidence regarding the "reciprocal carriage" hypothesis, the hypothesis that vertically integrated MSOs collude to favor their programming networks over independent networks. He asserts that his econometric analysis shows that MSOs that own a start-up network are more likely than cable systems that do not own the start-up network in question to carry their own network than a rival independent network; and that vertically integrated MSOs are more likely than non-vertically integrated MSOs to carry networks owned by other MSOs than independent networks, although the extent of the "bias" is small. He considers the possibility that vertically integrated MSOs may be more likely than non-vertically integrated MSOs to carry MSO programming simply because they carry more cable network programming. In the latter event, his foregoing findings would not be sufficient to justify the reciprocal carriage hypothesis. To test this, Kang estimates the relative likelihood that vertically integrated MSOs and non-vertically integrated MSOs carry independent cable networks. He finds that the vertically integrated MSOs are no more likely than the non-vertically integrated MSOs to carry such independent programming, which he interprets as evidence of the "reciprocal carriage" hypothesis.

[6] Although analyses based on bilateral bargaining theory are useful in some situations, when it comes to dealing with complex negotiations such as programming network carriage negotiations, which involve a large number of variables that affect bargaining decisions, it is often difficult to account for such variables and to obtain empirical verification of the theory being applied.

Kang's results could provide support for an ownership cap. However, as we demonstrate below, his results are not sustainable.

Critique of the Kang Paper

First, it is noteworthy that Kang does not claim based on his findings that observed cable conduct is anticompetitive; in fact, in his illustrative theoretical example, he assumes that consumer welfare is independent of which network is carried by which cable operator.

The more fundamental criticism of his paper, though, is that, his findings do not distinguish between the hypothesis that vertically integrated MSOs are favoring vertically integrated programming and the hypothesis that non-vertically integrated MSOs are favoring non-vertically integrated programming. Specifically, in his data sample, there are more start-up cable networks owned by MSOs than there are start-up cable networks not owned by MSOs. Thus, in Kang's sample, there are 20 percent *more* integrated cable networks than there are independent cable networks. If vertically integrated MSOs carried start-up networks in proportion to those in Kang's sample and non-vertically integrated MSOs favored independent networks, Kang's statistics would show that the vertically integrated MSOs were more likely than the non-integrated MSOs to carry integrated programming. Additionally, Kang would find that the vertically integrated MSOs were no more likely than the non-vertically integrated MSOs to carry independent programming. This is important because he interpreted this latter finding as refutation of the possibility that vertically integrated MSOs were more likely than non-vertically integrated MSOs to carry integrated programming simply because the former generally carry more programming than the latter. Thus, ultimately, given Kang's programming network sample skewed towards vertically integrated programming, his econometrics do not distinguish between the hypothesis that vertically integrated MSOs favor integrated programming over independent programming relative to non-vertically integrated MSOs, and the hypothesis that non-vertically integrated MSOs favor independent programming over integrated programming relative to vertically integrated MSOs.

Also, although Kang appropriately holds some confounding influences constant, he is likely to have omitted several explanatory factors that would help to explain program carriage by MSOs, including timing of launch relative to development of available channel capacity, launch timing as compared to competing programming, and the extent to which programming suits interests of unserved or underserved audiences or niches.

His paper, therefore, provides no evidence that distribution foreclosure is practiced by MSOs.[7]

III. Dong Chen and David Waterman, "Vertical Foreclosure in the U. S. Cable Television Market" (Aug. 7, 2005)

<u>Summary</u>

The Chen and Waterman paper provides an econometric estimation of the relative probability that Comcast and, alternatively, Time Warner, carry their own programming

[7] On a more technical level, there are also potential problems with his econometrics: many of his "control" variables are endogenous (i.e., influenced by the very dependent variables they are included to explain). Under such circumstances the effects estimated through regression analysis are biased in uncertain directions. Since we do not have access to his data, we cannot determine whether his results would withstand changes in the model specifications to address issues of endogeneity.

networks, and of the relative probability that Comcast and, alternatively, Time Warner, carry equivalent programming. Relative probability is defined here as relative to other cable operators' carriage decisions. For example, Comcast owns Outdoor Life Network (OLN), while the Outdoor Channel (OC) is an independently owned network that Chen and Waterman assume competes with OLN. Chen and Waterman estimate that in 2004, relative to other cable companies, Comcast was 20 percent more likely to carry its OLN and 30 percent less likely to carry the OC.

The authors properly focus on carriage decisions in situations in which competition is between (or among) MSO-owned and independent networks. This is because it is plain that an MSO likely does not have any incentive to discriminate against independent networks whose programming does not directly compete with programming provided by the MSO-owned networks. Of course, focusing on competitive networks opens the possibility that MSOs with limited channel capacity relative to the range of different programming in demand will have sound business justification for favoring their own networks even absent any hypothetical anticompetitive (exclusionary) objective.

Chen and Waterman performed a similar analysis for The Cartoon Network (affiliated with Time Warner) and Toon Disney (Independent); for Turner Classic Movies (affiliated with Time Warner) and other networks such as America Movie Classics ("AMC"), Fox Movie Network ("FMN"), and Independent Film Channel ("IFC") (Independent); and, lastly, for premium networks: Time Warner's HBO and Cinemax versus independent networks, including Showtime, The Movie Channel ("TMC"), Encore, Starz!, Flix, and Sundance Channel.

They found that Time Warner is more likely than other cable companies to carry Cartoon Network but, also, the same excess probability (positive relative probability) applies as well for Toon Disney; and Time Warner is more likely than other cable companies to carry Turner Classic Movies, but equally likely to carry AMC, FMN, and IFC.

Besides HBO and Cinemax, six premium movie channels were assessed in the Chen and Waterman paper. For the six, Time Warner was equally likely to carry the networks in three instances and less likely in the other three. For HBO, Time Warner was *less* likely than other cable operators to carry HBO on an analog channel.

Critique of the Chen and Waterman Paper

As an initial matter, in order to conduct their study, Chen and Waterman necessarily assume that the programming networks they include in the four different groups are equivalent. In reality, they do not offer equivalent programming. For example, HBO offers a wide range of programming including very popular programming such as Entourage and The Sopranos. It is highly dubious that Sundance Channel, Flix, Starz!, or TMC offer comparable programming. Similarly, OLN offers a much broader array of sports programming than OC's narrower focus on fishing, hunting, prospecting, and four-wheeling. This calls into question the validity of Chen and Waterman's conclusions given that the independent networks do not compete with the vertically integrated networks and, therefore, Comcast and Time Warner would have no incentive to favor one network over another for any other reason than the attractiveness of the programming to their customers.[8]

Moreover, the results presented in the Chen and Waterman paper are mixed. For OLN and OC, they found that Comcast is no more likely than other cable operators to carry OLN on an analog channel; and no less likely than other cable companies to carry the OC on an analog channel. These results, even putting aside the problems discussed below, do not support the necessity of imposing *any* cable horizontal limit, let alone identify a particular limit that would be reasonable and justifiable.

A fundamental problem with the paper is that Chen and Waterman's findings do not support their conclusions. In light of the results, it is difficult to understand Chen's and Waterman's conclusion that, "While there are some notable exceptions, the carriage and network positioning patterns we have analyzed in this study are generally consistent with the vertical foreclosure hypothesis as we have defined it." For the outdoor life networks, the vertically integrated MSO (Comcast) was no less likely to carry the independent network on an analog channel than the non-vertically integrated MSOs, and no more likely to carry their own network on an analog channel. For the cartoon networks, the vertically integrated MSO (Time Warner) was more likely than non-vertically integrated MSOs to carry its own network and its independent network rival. Similarly, for the movie channels, the vertically integrated MSO (Time Warner) was more likely than its non-vertically integrated counterparts to carry its own movie channel as well as three other independent movie channels. Finally, for the premium networks, HBO and Cinemax, owned by Time-Warner, the results are split down the middle.

[8] Some of these factors are cited above in the *Critique of the Kang Paper*.

Their findings with regards to analog channels are very telling. According to their working hypothesis, vertically integrated MSOs intent on weakening their independent program rivals relegate their access to digital channels, which are less available to households than analog channels. In this way, independent start-up networks, if carried at all, gain access to fewer viewers which jeopardizes their viability. The authors report the relative likelihood of placement on an analog channel or in a basic tier for 10 independent networks. In one half of these, the vertically integrated MSO treated the independent program network unfavorably relative to their treatment by non-vertically integrated MSOs; for the other five independent program networks, there was no difference in treatment.

The authors' search for evidence of vertical foreclosure in terms of channel placement (high or low and analog versus digital) and tiering (basic, expanded basic, and premium) is misguided. As a matter of economic theory, in the absence of price regulation, if a vertically integrated MSO possessed market power as a buyer of programming it would exercise this power through price, not by providing lower quality carriage. As indicated by the authors, ". . . all programmers are able to influence the positioning decisions of cable operators by design changes in their network's programming, or by setting differential wholesale pricing, with respect to digital vs. analog carriage."

Finally, the authors state, "It was not possible to conclude from this study whether the foreclosure patterns we observe are efficient or anti-competitively motivated, or whether consumers are on net better off or worse off as a result."

In sum, the Chen and Waterman paper provides no justification for an ownership limit or any insight into what an appropriate limit would be. Rather, the paper's findings rely on false assumptions about the marketplace and do not support the conclusions Chen and Waterman draw.[9]

IV. William Shepherd, "Basic Economics" (July 2005)

Summary

This paper is more of a diatribe than a serious piece of economic analysis. There are many assertions about the cause of rising cable rates, the harms of bundling on rates and diversity, and the importance of the 30 percent ownership threshold. For example, Shepherd cites articles to support his view that dominant-firm conduct becomes a serious problem as market share approaches 30 percent, even though most of those articles are outdated. Shepherd further claims that DBS is not a strong competitor for cable, and therefore, the relevant market is cable only, not MVPD. Thus, the 30 percent threshold is, in his view, even more essential.

Critique of the Shepherd Filing

Shepherd's claims about bundling, rates, and diversity are misguided. As an initial matter, he makes no correlation between bundling, higher cable rates, and an ownership limit. In addition, he overlooks the record that establishes that with a la carte programming, there would be *less* programming created, not more, and *higher* rates, not

[9] In Waterman's theory paper, reviewed above, he finds that vertical integration serves to internalize the externality he describes which in his model leads to too little programming production. In addition to solving free rider problems associated with program funding, vertical integration also provides a means of sharing the risk of program failure and represents a partial solution to problems of opportunistic behavior that may result after commitments are made to create programming.

lower. There is a full discussion of this topic in the FCC's report on a la carte programming,[10] and the various economic submissions opposed to mandated a la carte.[11]

The claim that DBS is a weak competitor is also suspect. The FCC and the Department of Justice ("DOJ") have decided many times that there is a MVPD market which includes both cable and DBS.[12] Moreover, DBS continues to grow very rapidly – adding millions of subscribers each year and now serving approximately 28% of the total MVPD subscribers nationwide – while cable subscribership stagnates.[13]

On his point about competitive harm starting when a firm has 30 percent of the market, recent economic literature suggests that market shares are a weak indicator of competitive effects and the ability to exercise market power. One must go beyond simply looking at market shares and consider other factors, which are discussed in the Merger Guidelines. Various authors have opined about the market share threshold appropriate for "dominance" (see, for example, Landes and Posner and Geroski, Gilbert, and

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[10] Media Bureau, FCC, *Report on the Packaging and Sale of Video Programming Services to the Public* 53 (Nov. 18, 2004).

[11] *See id.* App. D (listing 11 economic analyses discussing the harms of a la carte).

[12] *See, e.g.*, *11th Annual Report* ¶ 6 ("[W]e find that consumers today have viable choices in the delivery of video programming, and they are exercising their ability to switch among MVPDs."); *In re Implementation of Section 11 of the Cable Television Consumer Protection & Competition Act of 1992*, FNPRM, 16 FCC Rcd. 17,312 ¶¶ 22-23 (2001) ("Perhaps the most important difference between the industry in 1992 and today is that in 1992 there was no clear nationwide substitute for cable. Today, on the other hand, DBS has a national footprint. . . . DIRECTV now is the third largest MVPD operator, after AT&T and Time Warner, and EchoStar is the eighth largest." (internal citations omitted)); *Second Further Notice* ¶ 67 ("We observe that DirecTV and EchoStar rank among the top five MVPDs today, and that DBS equipment prices have fallen significantly such that DBS has become more comparable to cable service.").

[13] DIRECTV and EchoStar are respectively the second and third largest MVPDs. Together they have approximately 26.13 million subscribers. *See* Press Release, The DIRECTV Group, Inc., *The DIRECTV Group Announces Second Quarter 2005 Results* (Aug. 4, 2005) (reporting 14.67 million subscribers as of June 30, 2005); Press Release, EchoStar Communications Corp., *EchoStar Reports Second Quarter 2005 Financial Results* (Aug. 9, 2005) (reporting 11.46 million subscribers as of June 30, 2005). 26,130,000 DIRECTV and EchoStar subscribers ÷ 93,300,000 total MVPD subscribers equals 28%. *See* Kagan Research LLC, *Kagan Media Index*, Kagan Media Money, July 26, 2005, at 6 (showing that there are 93.3 million MVPD subscribers nationwide).

Jacquemin).[14] There is no generally accepted magnitude, and estimates range substantially. The best approach to this issue is to recognize, as done in the classic paper by Landes and Posner, that the correct answer is case specific or, more correctly, market specific. They formally observe that the ability of a dominant firm seller to raise price depends on market demand elasticity, the hypothetical dominant firm's share, and on the supply elasticity of its rival suppliers. In the present instance, instead of market power to sell, the issue is buying market power. Here, the analog of the Landes-Posner "residual-demand" formula would look to the overall elasticity of programming supply, the hypothetical dominant firm share of purchases, and the elasticity of demand for programming by MVPD rivals.

However, as has been noted in several FCC proceedings, video programming is not a typical, so-called rivalrous good, in which "more for me means less for you."[15] Yet, only in this latter instance does the standard "residual demand elasticity" formula apply to a firm with substantial share. In contrast, for public goods like extant video programming, no single MVPD can reduce the volume of programming supplied to other MVPDs by forcing programmers to sell to it at a lower price. For programming that is yet to be developed, a dominant buyer may enjoy a stronger bargaining position vis a vis the rights owners or the program owner, but it will not use this power to squelch programming that would be created under more competitive conditions. Instead, the dominant buyer and the creators would jointly fund program development to create maximum value. Indeed, Raskovich has demonstrated that larger MVPDs find

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[14] W. Landes and R. Posner, "Market Power in Antitrust Analysis," *Harvard Law Review* (1981); P. Geroski, R. Gilbert, & A. Jacquemin, *Barriers to Entry and Strategic Competition*, Routledge (1990).

[15] See "Declaration of Janusz A. Ordover" in the Matter of *Applications for Consent to the Transfer of Control of Licenses*, MB Docket No. 02-70.

themselves to be pivotal buyers who wind up funding more than their "fair" share of program development costs.[16]

In either case, determining the minimum dominant firm share must proceed along non-traditional grounds for a non-rivalrous good like video programming. The FCC has favored the view that a start-up national network must reach forty percent of the country's MVPD subscribers to be viable. This presumption appears to be coupled with another that collusion between two firms is a foregone conclusion. In this case, if each of two MVPD firms controls 30 percent of the market and the two collude to deny access, there still would be a 40-share potential for a new network. Thus, the FCC's justification for the 30 percent ownership cap. By implication, the FCC defines the dominant-firm threshold to be 60 percent.

There are several shortcomings associated with this reasoning, the most important being the lack of empirical evidence that a start-up network's critical mass is 40 percent.[17] We are not aware of any credible evidence that 40 percent is required, nor are we aware of evidence that a critical mass must be obtained in a new network's first year after launch. Most likely, networks must achieve a minimum share initially with the expectation of future growth to a viable critical mass.

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[16] See Raskovich, footnote 5, *supra*.

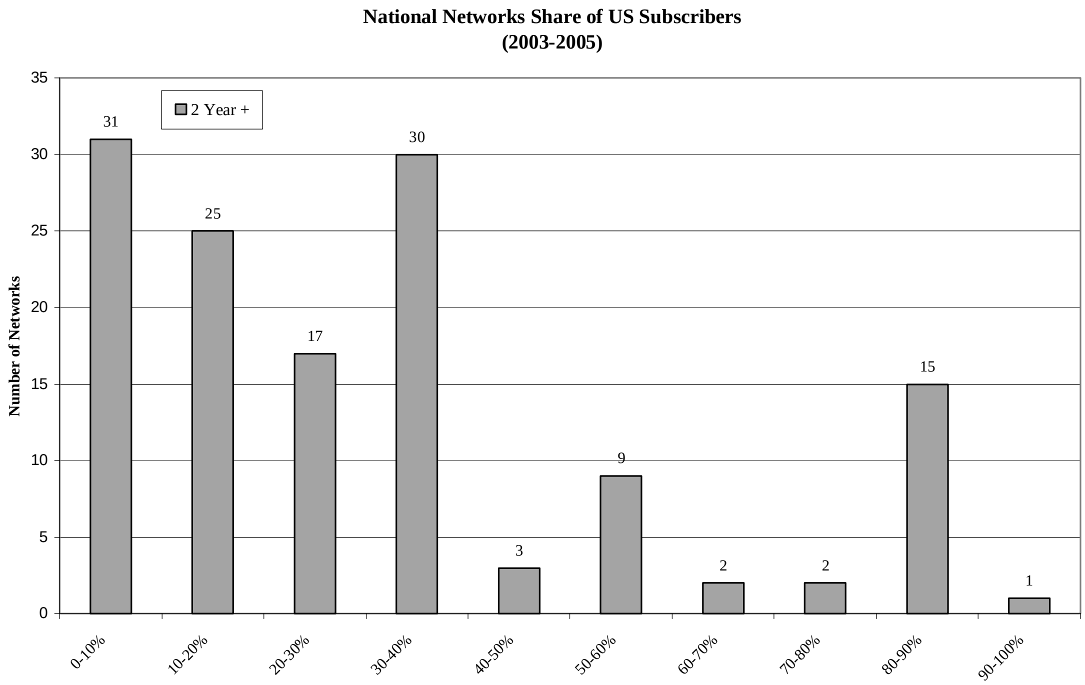
[17] The principal other weakness is the assumption that "two can readily tango" (i.e., collusion between two MVPDs is easy). We are aware of no serious analysis that supports this view with regards to MVPD players. Each colluder would have to forego carriage of valuable programming in many instances with no direct gain to itself. For example, Time Warner does not own an outdoor programming network; its refusal to carry the Outdoor Channel for the benefit of Comcast which owns Outdoor Life Network makes it difficult for the two companies to come to a tacit understanding to foreclose. There are other examples, as well, some of which are revealed above in the econometric paper of Chen and Waterman: Time Warner owns Turner Movie Classics and Cinemax and HBO whereas Comcast owns no such programming. Facially, a successful game of tit for tat for these two MVPDs would seem to confront substantial hurdles.

Based on NCTA data, we identified all of the national networks that as of the present have served U.S. MVPD customers for at least two years and for which continental U.S. subscribership data are available.[18] We apportioned the resulting sample of 117 networks to deciles based on percentage of total U.S. MVPD subscribers. Of these, 26 percent reach at most 10 percent of MVPD subs, and 47 percent reach at most 20 percent of MVPD subs.[19] These simple facts appear to contradict the view that anywhere near 40 percent of subscribers must be reached for a network to attain viability. Moreover, the distribution of these subscriber shares suggests that finding a single ownership cap to prevent distribution foreclosure is quixotic.

[18] Out of 316 networks, the number of U.S. subscribers and a launch date were available for 117 of them..

[19] See Appendix 1. The source is http://www.ncta.com/industry_overview/programList.cfm.

Appendix 1



Based on NCTA data there were 329 US networks with national and international subscribers.
For those for which there is launch date and US subscriber information we selected the 126 that were at least 2 years old.
Source: http://www.ncta.com/industry_overview/programList.cfm