July 17, 2007

Marlene H. Dortch
Secretary
Federal Communications Commission
445 Twelfth Street, S.W.
Washington, D.C. 20554

Re: Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, MB Docket No. 06-189

Dear Ms. Dortch:

CBS Corporation, Fox Entertainment Group, NBC Universal, and The Walt Disney Company hereby submit the attached paper, "The Effect of Retransmission Consent Negotiations On The Price and Quality of Cable Television Service," in response to the Supplemental Submission of the Coalition for Retransmission Consent Reform (CRCR) filed on February 15, 2007.

The paper demonstrates, counter to the assertions of CRCR, that only a small percentage of a typical cable system's programming costs result from retransmission consent payments to local broadcast stations. Broadcast stations' programming is the most-watched on cable television, and, in virtually all retransmission consent cases, market-based negotiations have resulted in the cable operator's carriage of the station's programming. In short, retransmission consent works.

Respectfully submitted,

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The Effect of Retransmission Consent Negotiations

On The Price and Quality of Cable Television Service

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July 10, 2007

[1] CBS Corporation, Fox Entertainment Group, NBC Universal, and The Walt Disney Company have retained David Leach to analyze and respond to the "Supplemental Submission" filed by the Coalition for Retransmission Consent Reform ("CRCR"), *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, Notice of Inquiry*, MB Docket No. 06-189 (filed Feb. 15, 2007) ("CRCR Supplemental Submission").

At the outset, CBS Corporation, Fox Entertainment Group, NBC Universal, and The Walt Disney Company wish to emphasize that they believe that cable television rates are a bargain for consumers, particularly when compared to the cost of almost every other form of entertainment. The point of this paper is not to argue that cable rates are too high, but simply to rebut the Coalition for Retransmission Consent Reform (CRCR) assertion that program costs, particularly retransmission consent-related program costs, are driving up cable rates charged to consumers.

In its Supplemental Submission, CRCR attempts to blame rising cable prices on retransmission consent practices and the cost to cable operators of obtaining programming, particularly from local broadcast stations and broadcast network-affiliated cable channels. According to available data, however, only a small percentage of a typical cable system's programming costs result from retransmission consent payments to local broadcast stations, even though these broadcast stations are routinely among the most popular channels sold by cable operators. Moreover, as demonstrated herein and on the attached "Anatomy of a Cable Bill", the total amount cable operators pay for *all* of the programming that they re-sell to consumers, including non-broadcast and broadcast programming, accounts for less than one-third of the revenue[2] that cable operators receive from subscribers to such programming. When you do the math, that leaves more than two-thirds of the amount cable subscribers pay for programming on

[2] "Programming-related revenue", "programming-related fees", "programming costs", and similar terms used throughout are intended to capture revenues or costs associated with programming carried by cable operators on the basic, expanded basic, and digital tiers, as well as content made available through pay-per-view ("PPV"), video on demand ("VOD"), and other premium services.

a monthly basis to go toward either cable operators' non-programming costs or for cable operators' profit.

To demonstrate, for years cable operators have charged consumers around $15 per month for so-called "lifeline" basic television service—program packages that contain few channels beyond local broadcast station programming—even as they have paid next to nothing to compensate local stations for carriage of their signals.[3] Cable operators routinely charge consumers more than $50 per month for "expanded basic" cable television service, even though the operators' programming costs typically equal only one-third of that amount.[4] For example, in 2006, the average total programming cost per month for Comcast, Time Warner, Charter, and Cablevision was $18.45, compared to average video subscriber revenues for the same four operators of $58.49 per month.[5] The cost-to-revenue comparison becomes even more stark with regard to the compensation paid to local broadcast stations: Based on calculations from available data, approximately 85 cents of these same four operators' monthly programming costs was due to retransmission consent fees paid out to *all* local television stations carried–less than two

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[3] *See, e.g., Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992: Statistical Report on Average Rates for Basic Service, Cable Programming Service, and Equipment*, 21 FCC Rcd 15087, 15093 (2006) ("2005 Cable Pricing Report"); *Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992: Statistical Report on Average Rates for Basic Service, Cable Programming Service, and Equipment*, 20 FCC Rcd 2718, 2725 (2005) ("2004 Cable Pricing Report").

[4] *See, e.g., Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 21 FCC Rcd 2503, 2521-22 (2006) ("2006 Video Competition Report").

[5] *See* Morgan Stanley, *Cablevision Systems, Leading Indicator: Resuming Coverage at Underweight-V* (Jan. 31, 2007) at 26; Morgan Stanley, *Comcast Corporation, Updated Forecast* (Feb. 1, 2007) at 26; Morgan Stanley, *Time Warner Cable, Inc., Premium FCF Growth at Premium FCF Multiple* (Feb. 21, 2007) at 22; Morgan Stanley, *Charter Communications, Time is on Their Side: Upgrading to Equal-weight-V* (Feb. 26, 2007) at 24. Moreover, this ratio of programming costs to revenues becomes even smaller if all of the monthly revenues received by a cable operator (e.g., service, installation, navigation device, home shopping, business services, telephony, Internet access) are included. Many cable operators are now selling programming as part of a bundle of voice and Internet access service for around $100 per month. *See, e.g.*, D.R. Stewart, *Added Cable Feature: Bundling: Cox Phone Service Now Covers Entire Area*, TULSA WORLD, Jan. 11, 2007 ("The Cox Essentials bundle of services includes digital cable with more than 100 channels, high-speed Internet, and digital telephone service ... for $99.99 a month").

percent of what their subscribers paid for video programming,[6] even though the local broadcast stations are among these cable operators' most-watched channels.[7] Clearly, then, the cost of programming, whether it be broadcast signals or network-affiliated cable channels, cannot be blamed for the rising cost to consumers of cable television services.

The Government Accounting Office ("GAO") agrees with this conclusion. In a 2003 report, the GAO determined that "[c]able networks that have an ownership affiliation with a broadcaster [do] not have, on average, higher license fees than cable networks that [are] not majority-owned by broadcasters or cable operators."[8] In attempting to undermine the GAO, CRCR uses data that is incomplete and misleading. Indeed, the methodology that CRCR uses to "explain" how and why rates have increased is inconsistent with any sound economic approach to the examination of price increases or trends, including failing to hold certain variables constant and to use the compound annual growth rate ("CAGR").

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[6] Estimated costs of broadcast programming are calculated by subtracting 2006 per-subscriber license fees for the 40 most widely-carried non-broadcast networks (*see* CRCR Supplemental Submission, Table 6) from the average annual programming costs for basic, expanded basic, digital, premium, PPV, and VOD (*see* 2005 Cable Pricing Report, 21 FCC Rcd at 15093), and multiplying by the ratio of broadcast stations to total channels carried by the average cable system, not including the 40 most widely-carried non-broadcast networks. (As the annual programming costs number from each year's Cable Pricing Report includes costs for digital, premium, PPV, and VOD programming, which for the most part are not included as part of cable operators' costs for the 40 most widely-carried non-broadcast networks cited by CRCR, the projection above likely overstates how much cable operators are paying to all local broadcast stations for the right to re-sell those stations' signals to their customers). For reference, the average number of broadcast stations carried is estimated to be 12.3 (*see id.*), and the average number of total channels carried is estimated to be 104.

[7] For example, for the week of May 28, 2007, the top-ranked broadcast television program (Fox's "House") had nearly 10 million more viewers than the top-ranked cable television program (TNT's NBA playoffs). Even the tenth-ranked broadcast television program (CBS's "Cold Case") had over 1.5 million more viewers than the NBA playoffs. *See* http://www.nielsenmedia.com, "Top TV Ratings" (visited June 6, 2007).

[8] U.S. General Accountability Office, *Report to the Chairman, Committee on Commerce, Science, and Transportation, U.S. Senate, Issues Related to Competition and Subscriber Rates in the Cable Television Industry*, GAO-04-8 (Oct. 2003) ("GAO Report") at 28. Interestingly, the GAO found that "license fees were statistically higher for cable networks owned by cable operators than was the case for cable networks that were not majority-owned by broadcasters or cable operators." *Id.* at 29.

Most importantly, the CRCR analysis is flawed because it fails to account for certain key considerations that are critical to any review of cable programming costs and revenues. For example, CRCR wholly ignores that:

- Some network-affiliated cable channels[9] were initially provided to cable operators free of charge, or even involved a launch fee paid to the cable operator in exchange for carriage, a fact that could disproportionately impact license fee increases for such channels in the years subsequent to launch;

- Some network-affiliated cable channels have never been tied to retransmission consent negotiations relating to the broadcast network's owned and operated stations, and thus any negotiated increase in the license fees for such channels cannot be attributed either to common ownership with a broadcast network or to retransmission consent practices;

- Over the period of time referenced in the CRCR Supplemental Submission, some non-affiliated cable channels' rates increased more than those of some network-affiliated channels, demonstrating a lack of correlation–not to mention causation–between ownership by a broadcaster and the license fees paid for cable programming (consistent with the findings in the GAO Report); and

- The level of compensation received for carriage of a cable channel is directly tied to ratings and demographics, which are based on the cost and quality of

[9] "Network-affiliated cable channels" refers herein only to non-broadcast cable networks in which a top-four broadcast network holds an ownership interest. The term does not refer to any broadcast stations carried on cable systems, including those that are affiliates of a top-four broadcast network.

programming,[10] as well as the comparative popularity of the channel,[11] and not on whether the channel is affiliated with a broadcaster.

Finally, CRCR suggests that increased competition to cable from direct broadcast satellite ("DBS") providers and telephone companies underscores, and even magnifies, the harms of retransmission consent. Yet, the GAO has found that in markets with wireline (rather than, or in addition to, satellite) competition to cable—i.e., telcos and cable overbuilders—cable rates have dropped by as much as 15%.[12] If cable rates were primarily based on programming costs, as CRCR asserts, it is difficult to imagine how a cable operator would be able to lower rates so dramatically and easily: Clearly, cable operators have substantial room to maneuver in setting their rates even if programming costs are taken into account. In addition, as CRCR acknowledges, less established video competitors, such as Verizon, have agreed to pay local television stations for their programming while being able to remain competitive with cable operators.[13] If new entrants can afford to acquire programming and offer competitive prices, how can CRCR's incumbent cable operator members claim that their programming costs are too high?

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Retransmission consent works. Pursuant to established federal requirements, broadcasters enter into good-faith negotiations with cable operators, even though these operators compete with local stations for viewers and advertising dollars. Broadcast stations'

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[10] *See, e.g.*, GAO Report at 23 (citing increased costs of programming due to competition among networks to produce and show content that will attract viewers).

[11] GAO Report at 29 ("[n]etworks with higher advertising revenues per subscriber (a proxy for popularity) ... receive[] higher license fees.").

[12] GAO Report at 3.

[13] *See* CRCR Supplemental Submission, n. 8.

programming is the most-watched on cable television, and, in virtually all retransmission consent cases, market-based negotiations have resulted in the cable operator's carriage of the station's programming.[14] These negotiations have not resulted in costs to cable operators that are (a) driving cable rate increases to subscribers, or (b) unfairly slanted in favor of network-affiliated programmers. Retransmission consent and the programming of network-affiliated cable channels impact cable subscription prices only by providing increased value to consumers. The percentage of cable subscriber rates that represents a pass-through of costs directly or indirectly related to retransmission consent is tiny compared to the value of broadcast signals and network-affiliated cable programming, as well as the overall benefits of the current retransmission consent model.

[14] In the extraordinarily rare cases where there is a temporary loss of carriage on a particular cable system, viewers rarely lose all access to a local signal. Although CRCR blames the recent increase in telco-provided video services for diminishing cable operators' leverage in retransmission consent negotiations, broadcasters have had alternative distribution systems–most notably, over-the-air–available since the advent of retransmission consent.

ANATOMY OF A CABLE BILL: Programming costs constitute less than one-third of the monthly programming-related revenue received by cable operators.

TYPICAL CABLE, INC.

Account No.: Typical American Household	Service Period: Monthly	DUE DATE:

Service for: Typical American Household
Customer Name: Mr./Mrs. US Consumer
Anytown, USA

We thank you for being a Typical Cable, Inc. subscriber.
If you have any questions regarding your bill please call our office at 777-9311.

Previous balance.....$ XXX.XX
Payments Received as of (03/29/2003).....$ XXX.XX
Monthly Services.....$ XXX.XX
Taxes & Fees.....$ XXX.XX
TOTAL AMOUNT DUE.....$ XXX.XX

MONTHLY CABLE BILL

Average revenue per subscriber received by cable operator for programming[1] $52.98

\+ Average local advertising revenues per subscriber received by cable operator[2] $4.49

Average total programming-related revenue per subscriber $57.48

Programming costs per subscriber paid by cable to programmers[3] $16.16

/ Average total programming-related revenue per subscriber $57.48

Percentage of programming costs to programming revenues received by cable ... 28.1%

Programming costs per subscriber paid by cable to programmers $16.16

\- Average local advertising revenues per subscriber received by cable operator[4] $4.49

Net programming costs per subscriber $11.67

Net programming costs per subscriber paid by cable to programmers $11.67

/ Average programming-related revenue per subscriber $52.98

Percentage of net programming costs to programming revenues 22.0%

Retransmission consent fees paid by cable to all local TV stations carried $0.85

/ Average total programming-related revenue per subscriber $57.48

Percentage of broadcast retransmission costs to programming revenues 1.5%

NOTES

[1] *See Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 21 FCC Rcd 2503, 2521-22 (2006) ("2006 Video Competition Report"). This amount is calculated by adding all programming-related revenue segments in Table 4 of the 2006 Video Competition Report (basic, expanded basic, video on demand, and digital), dividing by the total number of subscribers (65.4 million), and dividing by 12 to obtain a monthly number.

[2] *See id.* This amount is calculated by taking the total yearly amount from Table 4 ($3,527 million), dividing by the total number of subscribers, and dividing by 12.

[3] NCTA Video Competition Comments at 40, cited in 2006 Video Competition Report, 21 FCC Rcd at 2522.

[4] Given that local advertising availability typically is negotiated as part of carriage agreements, it is perhaps more accurate to subtract these revenues from the total programming costs.