**Before the**
**Federal Communications Commission**
**Washington, D.C. 20554**

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| In the Matter of | ) | |
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| Implementation of the Cable Television Consumer Protection and Competition Act of 1992 | ) | MB Docket No. 07-29 |
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| Development of Competition and Diversity in Video Programming Distribution: Section 628(c)(5) of the Communications Act: | ) | |
| | ) | |
| Sunset of Exclusive Contract Prohibition | ) | |
| | ) | |
| Review of the Commission's Program Access Rules and Examination of Programming Tying Arrangements | ) | MB Docket No. 07-198 |

# WHY THE FCC SHOULD NOT INCREASE REGULATION OF WHOLESALE TV PROGRAMMING: REPLY TO COMMENTS IN MB DOCKET NO. 07-198

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CRITERION ECONOMICS, L.L.C.

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## I. INTRODUCTION

1. I prepared a report on behalf of The Walt Disney Company ("Disney") which was filed with Disney's comments in this proceeding. I have been asked by Disney's counsel to prepare this further report, which responds to some of the issues raised in the comments filed by other parties, including specifically the comments submitted by the American Cable Association (ACA), National Telecommunications Cooperative Association (NTCA) and OPATSCO (collectively, "Regulation Advocates").

2. Regulation Advocates, who are comprised virtually entirely of "small" or "rural" cable and telephone companies,[1] advance proposals for additional regulation of the wholesale market for both broadcast and cable network programming. Specifically, they propose to proscribe certain types of provisions in contracts between programmers and cable operators, including prohibiting bundled discounts, banning provisions relating to distribution of programming, and imposing "most-favored nation" clauses. To achieve these ends, they would have the Commission establish and impose "reasonable" prices for programming of all kinds. The primary rationale given for these proposed regulations is the (unsupported) assertion that the current rules place "small" or "rural" cable operators ("SROs") at a competitive disadvantage (relative to larger operators and/or DBS operators) in their ability to acquire programming.

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[1] Among Regulation Advocates, only NTCA appears to provide a clear definition of what constitutes a "small" cable operator, embracing the Commission's definition that a "small cable operator" is one with 400,000 or fewer subscribers. See NTCA Comments at 3; see also *In the Matter of Implementation of the Cable Television Consumer Protection and Competition Act of 1992; Development of Competition and Diversity in Video Programming Distribution: Section 628(c)(5) of the Communications Act: Sunset of Exclusive Contract Prohibition; Review of the Commission's Program Access Rules and Examination of Programming Tying Arrangements*, MB Docket No. 07-29, 07-198 (released Oct. 1, 2007) [hereafter *NPRM*], Appendix F at ¶14. Other Regulation Advocates appear to define "small" or "rural" operators as "our members." As discussed below, I adopt the 400,000 subscriber threshold, except where specifically noted.

3. In Section II below, I analyze Regulation Advocates' arguments with respect to the supposed disadvantages faced by SROs under the current rules. I show that Regulation Advocates have failed to demonstrate that SROs, however defined, are at a disadvantage when it comes to acquiring programming, let alone that any "disadvantage" they may face is a consequence of any sort of actionable market failure. Indeed, I show that SROs as a group tend to have certain important *advantages* over larger operators, especially with respect to retransmission consent negotiations.

4. In Section III below, I discuss Regulation Advocates proposals for regulatory intervention, including their proposals to ban contracts that involve bundling or distribution requirements, to impose "non-discrimination" or "most-favored nation" rules, or to engage in outright price regulation. I demonstrate that Regulation Advocates have not only failed to establish a rational basis for such regulations, but that their proposed regulations would be profoundly unworkable, and that any attempt to implement them would be disastrous for the Commission, the industry and, most importantly, consumers.

## II. REGULATION ADVOCATES FAIL TO DEMONSTRATE THAT SMALL CABLE OPERATORS ARE DISADVANTAGED BY THE CURRENT SYSTEM

5. The "evidence" presented by Regulation Advocates to support their case that SROs are at a competitive disadvantage consists of unsupported anecdotes, unscientific and unreliable surveys, and flawed or inapplicable analyses. Comments submitted by ACA and NTCA rely heavily on two studies, one by the Congressional Research Service ("CRS Study")[2]

[2] Charles B. Goldfarb, *Retransmission Consent and Other Federal Rules Affecting Programmer-Distributor Negotiations :Issues for Congress* (Congressional Research Service, July 9, 2007) at 67.

and one by the Ball State University Digital Policy Institute ("BS/DPI Study")[3] to support the proposition that small and/or rural cable operators are at a disadvantage in acquiring programming. As I explain in Section II.A. below, neither study supports the propositions for which they are relied upon; nor does any of the other evidence presented by Regulation Advocates demonstrate that SROs are at a disadvantage of any sort.

6. To further examine the relationship between SROs and programming negotiations, I analyzed market conditions in markets where SROs typically operate, including the extent to which small operators face competition from DBS operators carrying local broadcast signals, the extent to which local broadcast stations are able to reach SRO subscribers with their over-the-air signals, and the extent to which SROs face competition from overbuilders. My analysis, reported in Section II.B below, shows that SROs actually have significant *advantages* (relative to large MSOs) when it comes to negotiating for programming.

7. Regulation Advocates' case for intervention rests heavily, if not exclusively, on the notion that the mere existence of so-called "must have" programming justifies regulation. As I explain in Section II.C., "must have" does not constitute a meaningful analytical framework, nor does it provide useful guidance in assessing whether additional regulation is necessary or would increase consumer welfare.

### A. Regulation Advocates Fail to Demonstrate that Small or Rural Operators are Harmed by the Current System

8. Regulation Advocates' claims that SROs are somehow disadvantaged relative to other MVPDs in acquiring programming are just that: Claims. But Regulation Advocates fail to support their claims with either reliable evidence or meaningful analysis.

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[3] *Retransmission Consent, Must Carry and the Public: Current Economic and Regulatory Realities of Multichannel Video Providers: A White Paper by the Ball State University Digital Policy Institute* (Commissioned by the National Telecommunications Cooperative Association, October 3, 2007).

9. To begin with, ACA and OPASTCO cite surveys of their members. In both cases, the resulting "evidence" fails to meet even the most *de minimis* standards of survey research. Neither ACA nor OPASTCO provide copies of the survey instrument (i.e., the questions asked) nor other rudimentary information about survey methodology necessary to determine whether the surveys are biased and, if so, how.[4] Thus, statements such as "ACA members estimate that programmers charge them per-subscriber license fees approximately 30% higher than the license fees paid by the major MSOs,"[5] and "43 percent of respondents indicated that they could not obtain video content that is critical to their service offering,"[6] constitute nothing more than hearsay, and should be disregarded by the Commission.

10. ACA relies on the CRS Report to support its contention that "discrimination occurs in retransmission consent as broadcasters target vulnerable small systems for substantially higher retransmission consent fees."[7] But the CRS Report provides no meaningful evidence with respect to SROs, at least not if they are defined, as they are by the FCC, as MSOs with fewer than 400,000 subscribers.

11. The CRS Report presents anecdotal evidence from six publicly reported recent instances of retransmission consent negotiations, including negotiations involving Nextar, CBS, Dish Network, Sinclair and Time Warner.[8] However, only one of these anecdotes even potentially involves small cable systems, and that anecdote hardly supports Regulation Advocates' case. Specifically, the CRS report recounts the following episodes:

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[4] See, e.g., Shari Seidman Diamond, "Reference Guide on Survey Research" in *Reference Manual on Scientific Evidence*, 2d (Federal Judicial Center, 2000) at 229-76 (available at http://air.fjc.gov/public/fjcweb.nsf/pages/16).

[5] ACA Comments at vi.

[6] OPASTCO Comments at 5.

[7] ACA Comments at 18.

[8] Goldfarb at 31-55.

- Nextar's negotiations with Cox (5,424,000 subscribers)[9] and Cable One (696,700 subscribers), neither of which is an SRO.[10]

- CBS's retransmission agreements with nine unidentified "small" cable operators, which CBS reported involved cash compensation. However, the terms of the deals touted by CBS have not been released, and the press report upon which CRS relies states that "several Wall Street analysts and at least one broadcaster were skeptical that CBS was getting just cash from these operators."[11]

- Dish Network's negotiations with Lifetime and Hearst-Argyle, which obviously provide no evidence relevant to negotiations between programmers and SROs.

- Sinclair's negotiations with Mediacom (1,344,000 subscribers), Suddenlink (1,416,800 subscribers), Time-Warner (13,391,000 subscribers), Comcast (24,141,000 subscribers) and Charter (5,376,800 subscribers). Obviously, none of these systems are "SROs" based on the 400,000 subscriber criteria.[12]

- Time Warner's negotiations with the CW Network, in which it was successful in winning cash payments in return for carrying certain CW stations (i.e., "reverse cash for carriage").

12. Thus, the CRS Report fails to provide *any evidence whatsoever* that "discrimination occurs in retransmission consent as broadcasters target vulnerable small systems for substantially higher retransmission consent fees." To the contrary, the report shows three things: First, broadcasters appear to be completely *undiscriminating* in their efforts to obtain cash retransmission compensation from MVPDs of all stripes and sizes; second, the available evidence suggests they have been about as successful (not very) with large operators as with small ones; and, third, to the extent any conclusions at all can be drawn from these anecdotes,

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[9] Subscriber numbers reported in this section are from http://www.ncta.com/Statistic/Statistic/Top25MSOs.aspx

[10] The report notes that, as a result of a negotiating impasse in which some of its stations were not carried on Cox and Cable One systems, "Nexstar stations' ratings plunged and their advertising revenues fell accordingly. Nexstar acknowledged losing several million dollars in revenues." (CRS Report at 33.)

[11] Linda Moss, "CBS Eyes New Deals," Multichannel News, February 26, 2007 (available at http://www.multichannel.com/index.asp?layout=articlePrint&articleID=CA6419389). Notably, the negotiations involved did not reach an impasse; no stations were "taken down" from any of the cable operators' systems.

[12] Moreover, the anecdotes involving Sinclair hardly support the conclusion that small operators are at a disadvantage. For example, Sinclair insists that its agreement with Comcast, the nation's largest cable carrier, included "cash for carriage."

that retransmission consent negotiations are intensely situation-specific, with the value placed on carriage (by programmers) and on programming (by MVPDs) varying according to a number of largely qualitative factors (e.g., local demand for a particular sporting event based on the home team's success in reaching the playoffs). As discussed further below, the presence of such factors would make it practically impossible for the Commission to distinguish "reasonable" from "unreasonable" contractual terms, as Regulation Advocates' proposals require.

13. NTCA's comments rely on a lengthy study by the Ball State University Digital Policy Institute. According to the comments, "The paper finds that the current regulatory environment supports the maintenance of a skewed playing field where Broadcasters control all elements of price, terms and conditions of negotiations with MVPDs."[13]

14. To the contrary, the BS/DPI Report finds no such thing. Rather, like the CRS study, it fails to provide *any* evidence or credible analysis in support of Regulation Advocates' proposals. First, its conclusions are based on pure speculation about the meaning of "fairness"[14] and the relative business acumen or "sophistication" of various market participants,[15] implying that the Commission should put in place regulations designed to ensure that parties to bi-lateral negotiations "share equally" in the gains from trade from their agreements, or that it single out "unsophisticated" MSOs for special protection. How the Commission is supposed to measure "gains from trade," establish criteria for their "fair" division, identify "sophisticated" versus

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[13] NTCA Comments at 22.

[14] The report cites a single experimental psychology study which purports to demonstrate that "fairness" requires that the gains from trade in bargaining situations be divided equally between the two parties, but it fails to demonstrate – because it cannot be demonstrated – that consumers would be affected, one way or another, by how the gains from trade between programmers and cable operators are divided. Nor does it demonstrate how such gains from trade could be measured to determine whether they are divided "fairly."(BS/DPI Study at 46-48.)

[15] The report presents to an entirely speculative set of examples constructed to show that if cable operators are sufficiently "unsophisticated" they might negotiate bad deals with broadcasters. (BS/DPI Study at 50-55.) The report presents no evidence, however, that small cable companies are "unsophisticated," nor does it explain how the FCC could identify such companies or assist them in making better decisions.

"unsophisticated" businessmen is, or intervene constructively on behalf of the latter, is never explained.

15. Second, to the extent the BS/DPI report does present any factual evidence, the conclusions it draws from that evidence are explicitly self-contradictory. Specifically, the report focuses on the outcomes of two recent retransmission consent negotiations, Mediacom/Sinclair and Suddenlink/Sinclair, the outcomes of which it, it explains, were the proximate cause of its sponsors' (NTCA's) decision to advocate increased regulation in this proceeding.[16] However, in its review of these cases, the report reaches two strikingly different – and irreconcilable – conclusions. On the one hand, it argues that the Commission's failure to intervene in either matter "creates an environment, similar to Las Vegas where the odds are always with the house, and in which negotiations are conducted on less than a level playing field,"[17] and cites the outcome of the Mediacom-Sinclair negotiation as evidence that the Commission was incorrect in its decision not to intervene.[18] On the other hand, the report cites Mediacom-Sinclair specifically as an example of a negotiation in which "both sides have reasonably equal negotiating power,"[19] identifies Mediacom as a firm which, having 1.3 million subscribers, has "sufficient market clout and internal resources to protect their interest,"[20] and concludes the FCC's "reluctance" to intervene in the proceeding was "probably a reasonable policy response."[21] We are all familiar with the joke about the "two-armed economist," but this seems absurd.

[16] BS/DPI Study at 37.
[17] BS/DPI Report at 63.
[18] BS/DPI Report at 64.
[19] BS/DPI Report at 63.
[20] BS/DPI Study at 50. One can infer, though the authors do not explicitly state, that Suddenlink is also sufficiently "sophisticated" to look after its own affairs, as it has more subscribers (1.4 million) than Mediacom.
[21] BS/DPI Study at 49.

**B. Small/Rural Operators Face Less Downstream Competition Than Large Operators**

16. Regulation Advocates also base their calls for intervention on the notion that SROs are at a growing disadvantage as a result of the increasingly competitive downstream marketplace – i.e., as a result of competition from DBS and/or from telephone companies and other overbuilders.[22] The facts demonstrate otherwise.

17. For example, SROs are more likely than large systems to operate in areas where local broadcast stations are not carried by one or both DBS operators, thereby depriving the local broadcaster of the option of "by-passing" the local cable system in favor of DBS during a retransmission dispute. In addition, SROs are more likely than large systems to operate outside the broadcast coverage territories of the local broadcast stations, and thus in many cases offer the *only* means by which broadcasters can reach these customers. Small cable operators are, simply put, more likely than large ones to have many of the negotiating advantages that play a role in the resolution of retransmission agreements. Finally, SROs are significantly less likely to face competition from overbuilders. Indeed, many SROs are operated by the local RLEC, are thus almost certain *never* to face competition from telco entry into video.

18. As a general matter, carriage of local broadcast stations is important to the ability of DBS operators to compete with cable. In retransmission consent disputes, the availability of local programming via DBS assumes particular importance, as one of the tools broadcasters use when retransmission disputes arise is to encourage customers to get their signals by subscribing to DBS – an option which is, of course, available only if the local broadcaster's signal is carried on one or both of the DBS operators' "local into local" packages. Furthermore, from the perspective of the broadcaster, it is most advantageous if its signal is carried by both DBS

[22] See ACA Comments at 18, n. 13; BS/DPI study at 49, NTCA Comments at 13.

operators, both because it increases the likelihood that any given consumer could "see" at least one of the DBS operators' satellites, and because it gives consumers the ability to choose the DBS provider whose packages otherwise best serve their needs.

19. I examined the extent to which cable systems owned by an MSO with fewer than 400,000 subscribers operate in areas where local broadcast stations are not carried by DBS providers.[23] Overall, 26 percent of the cable systems (885 systems) owned by small MSOs operate in areas where only one DBS operator carries local broadcast programming, and six percent operate in areas where no DBS operators carries local broadcast programming. For cable systems operated by large MSOs, by contrast, only 22 percent (816 systems) operate in areas where one DBS carrier carries local programming, and seven percent operate in areas where there is no DBS local-into-local carriage. By this definition, then, small operators are at least on an even playing field with large ones when it comes to retransmission consent negotiations.

20. I also examined the extent to which cable systems serving franchise territories with fewer than 150,000 households[24] face local-into-local competition from DBS providers. By this measure, small operators have a clear advantage over large ones. Nearly 1,700 (1,698) small cable systems (representing 31 percent of all small systems) operate in areas where there is local-into-local carriage by at most one DBS operator, and 489 (seven percent) operate in areas where there is no local-into-local DBS carriage at all. By contrast, all but three of 156 large systems face local-into-local competition from both DBS operators. By this measure, small operators have a clear advantage over larger ones.

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[23] I obtained data on cable systems' coverage territories from Warren's Cable Fact Book, and on local broadcast carriage by DBS operators from the DirecTV and Dish Network web sites.

[24] I chose the 150,000 household threshold based on the FCC's definition of small cable systems as those having fewer than 100,000 subscribers. See 12th MVPD Report at ¶203. Assuming a 67 percent penetration rate, such a system would be one whose franchise territory covers 150,000 or fewer households.

21. I also examined how cable systems owned by small MSOs (fewer than 400,000 subscribers) compare with cable systems owned by large MSOs in terms of the ability of broadcasters to reach subscribers directly over the air. I defined a cable system as facing over the air competition if more than 50 percent of the households in its franchise territory were within the Grade B contours of the local network-affiliate broadcast stations. Overall, 40 percent of cable systems (1,390 systems) owned by small MSOs operate in areas where local broadcast programming is available from two or fewer "big four" network affiliates, compared with only 24 percent of cable systems (901 systems) owned by large MSOs.[25]

22. As with the DBS comparison, I performed the same analysis based on a definition of a small operator as one serving fewer than 150,000 households. One third (33 percent; 2,290 systems) of small systems operate in areas where two or fewer network signals can be received over the air, but not a single large system meets this criterion.

23. Another asserted source of small operators' "growing disadvantages" is the increasing presence of overbuilders. However, large operators are far more likely than small ones to face such competition. First, the primary recent development with respect to overbuilding is the advent of Verizon's FiOS and AT&T's "U-Verse" video products. However, these systems are being deployed primarily in more densely populated areas, and this is unlikely to change in the foreseeable future. Second, as noted briefly above, in many cases small MVPDs are operated by the local telephone company itself. Indeed, NCTA's comments report that of NTCA's 580 members (all of which are incumbent local exchange carriers) "the vast majority" provide video as well as voice service, and 276 (48 percent) provide coaxial cable (CATV)

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[25] The same relationship holds no matter how many broadcast signals one uses as the cutoff. For example, 463 systems (14 percent) owned by small MSOs are in areas which receive *no* network channels over the air, compared with only 212 (six percent) owned by large MSOs.

service.[26] In nearly half of all NTCA communities, in other words, the phone company *is* the cable company, and the prospect of wireline video competition is, for practical purposes, non-existent.

24. I also examined the extent to which cable operators are subject to competition from overbuilders, using data from Warren's Cable Fact Book, and found that small cable operators, whether defined by the size of the MSO or by the size of the individual system, are substantially less likely to be subject to competition from overbuilders than are large ones. Specifically, only 2.4 percent (82) of systems owned by small MSOs have competition from overbuilders, compared with 8.0 percent (300 systems) of systems owned by large MSOs; and, only 4.7 percent (327) of small cable systems have competition from overbuilders, compared with 35.3 percent (55) of large systems. Again, small cable operators have the advantage over larger ones.

### C. The Existence of "Must Have" or "Desirable" Programming Does Not Provide a Basis for Regulation

25. Regulation Advocates support their calls for increased intervention on the basis of their claim that cable programmers and broadcasters control "must have" programming – and, it must be said, they can and do cite the Commission's NPRM and its embrace of the distinction between "more" and "less" desirable programming for support.[27] The Commission's increasing reliance on such concepts, however, is both unfounded and dangerous, as it replaces sound competition analysis with a construct which is neither well-defined (witness the Commission's reference to the Soprano's in the NPRM)[28] nor closely tied to consumer welfare. The

[26] NTCA Comments at 1.
[27] See, e.g., OPASTCO Comments at 8, citing NPRM at ¶120.
[28] NPRM at ¶38.

Commission's reliance on such concepts is especially notable because it represents such a rapid and radical departure from the much firmer ground upon which it has based its prior analyses. Less than four years ago, for example, the Commission explained its decision in the News Corp./DirecTV transaction as follows:

> All differentiated products, such as video programming, possess some degree of market power in the sense that there are no perfect substitutes. The critical question in any analysis involving differentiated products is ***whether the existing degree of market power is sufficient to allow the firm to profitably engage in the hypothesized anticompetitive activity….***[29]

26. This question – whether the existing degree of market power is sufficient to permit firms to engage in some hypothesized anticompetitive activity – remains the standard by which the issues in this proceeding should be judged.[30] The simple fact that some programming is more desirable than other programming does not demonstrate the existence of market power, any more than the fact that more consumers buy Fords than Hyundais makes Ford a monopolist. As economist Bruce Owen explained in his report in this matter, the concept of "must have" programming is "economic nonsense."[31]

## III. THE PROPOSED REGULATIONS WOULD LEAD INEVITABLY TO AN UNWORKABLE SYSTEM OF PRICE CONTROLS

27. Everyone would like to pay less for the things they buy. Steel companies would like to pay less for coal; car companies would like to pay less for steel; consumers would like to pay less for cars. Cable operators would like to pay less for programming.

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[29] *Report on the Packaging and Sale of Video Programming Services to the Public* (Nov. 18, 2004) at 70.

[30] See also Eisenach Report at ¶46

[31] See Bruce W. Owen, *Wholesale Packaging of Video Programming* (January 4, 2008) at 2, 29-32. (Attached to NBC Comments as Exhibit B.) Note that even Regulation Advocates cite instances in which MVPDs "just say no" to supposedly "must have" or "desirable" programming. See e.g., NTCA Comments at 17 (detailing Canby Telecom's decision to turn down Comcast SportsNet and NFL Network programming).

28. Politicians and regulators are frequently called upon to meet these desires, and they have at their disposal, at least in theory, the power to do so: They can simply mandate that sellers charge less – that is, they can impose price controls.[32]

29. Regulation Advocates – fearing, perhaps, that a direct plea for price controls would meet with resistance (as it should, since the *only* economically sound basis for price controls, the existence of a natural monopoly, is so obviously lacking in this market) – instead propose a variety of limits on the types of contracts that can be entered into between programmers and cable operators. But the regulations they propose have a common characteristic: They cannot be meaningfully implemented without the imposition – whether implicitly or explicitly, directly or indirectly, immediately or eventually – of wholesale price controls on television programming. And no matter what form they take, price controls over wholesale television programming would prove unworkable, distortionary, and damaging to the Commission, the industry and consumers.

## A. Bundling Prohibitions Would Require Price Controls

30. Regulation Advocates have produced no evidence that programmers engage in outright tying, and programmers have testified that they do not. Thus, the practices at issue in this proceeding do not involve "pure bundling" of programming content – i.e., the refusal to sell programming on an *a la carte* basis at some price. Instead, they involve the ability of programmers to charge different prices for their programming based on the types and amount of programming purchased by each operator. Further, there appears to be little or no disagreement about the nature of such bundles. They are bundled *discounts,* in which operators who purchase more, pay less.

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[32] I am not suggesting that the FCC has the authority in this instance to enact any of the regulations advocated by Regulation Advocates. To the contrary, Disney and others have argued persuasively that it does not.

31. Cable operators find such offers offensive, as they would prefer to pay the discounted bundled price while purchasing *a la carte*. To achieve this objective, they propose to ban "mandatory" bundles. But how would such a ban be implemented in practice?

32. Suppose, for example, the Commission were to agree to OPASTCO's proposal that it simply "preclude the mandatory tying of programming."[33] What exactly would it be prohibiting? First, nowhere do Regulation Advocates suggest banning *all* contracts that cover more than one type of service or one programming network (i.e., "bundled contracts"), when such contracts are entered into "voluntarily." Second, "voluntary" in this instance clearly means that the prices, terms and conditions are viewed as "reasonable" by the cable operator. (Even OPATSCO admits that its members do not complain of mandatory tying as such, but rather of "being presented with 'take it or leave it' offers that may technically permit them to obtain programming, but not under reasonable prices, terms or conditions.")[34] Thus, what OPASTCO and other Regulation Advocates actually seek – as the ACA freely admits – is that the Commission force programmers to "offer each channel on a standalone basis on reasonable rates, terms and conditions."[35] Indeed, such a requirement would be necessary to implement a ban on "mandatory" bundling, since without a price constraint, programmers could avoid such a ban simply by setting the *a la carte* prices at levels that cause all operators to choose a bundle.[36]

## B. Prohibitions on Distribution Requirements Would Require Price Controls

33. Regulation Advocates also plead for the Commission to prohibit distribution requirements.[37] Again, what is the Commission to make of this proposal? No commenters

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[33] OPASTCO Comments at 19.
[34] OPASTCO Comments at 10.
[35] ACA Comments at 22.
[36] Note that Dr. Owen demonstrates clearly this is not the situation today, as programmers purchase all manner of a la carte and packaged programming. See Owen Report at 9-24.
[37] See e.g., ACA Comments at 25.

appear to demand that it prohibit *all* contracts that include provisions relating to distribution, so once again Regulation Advocates' proposal can only be interpreted as meaning that the Commission should ban *"mandatory"* distribution requirements – i.e., those they view as "unreasonable." And how will the Commission distinguish between "reasonable" and "unreasonable" requirements? Because distribution requirements inevitably affect prices – programmers are willing to charge less (or pay more) for wider distribution – it could only implement such a policy if it were prepared to distinguish between "reasonable" discounts for broader distribution and unreasonable ones, i.e., if it were prepared to impose price controls based on the extent of distribution.

**C. Non-Discrimination Rules Would Require Price Controls**

34. The ACA proposes that "the Commission should prohibit volume-based price differences, unless those differences are genuinely cost-based."[38] Here the call for price controls is bald: The Commission should distinguish between prices that are "cost-based" and those that are not, and prohibit the latter. That is, it should impose price controls.

**D. The Commission Could Not Implement a Rational System of Wholesale Price Controls on Television Programming and Should Not Try**

35. The Commission has a long (and controversial) history of controlling prices. But does anything in its experience prepare it for the exercise in which Regulation Advocates now propose it engage? Is it prepared, *de novo*, to begin writing cost allocation rules in order to direct programmers how to allocate costs between "desirable" and "undesirable" programming? How will it calculate programmers' cost of capital and required revenues, in order to assess whether their rates are "cost-based" (including a reasonable return on capital)? How is risk to be assessed – will a network that generates multiple "hits" in a given year be permitted to benefit from its

[38] ACA Comments at 23.

success (or luck) in the ensuing round of retransmission consent negotiations, or will such profits be disapproved as unfair "windfalls"? (Perhaps the answer would turn on costs – high-cost situation comedy "hits" being valued more heavily than relatively cheap reality show "hits" – or even content, with "family" or "educational" hits granted a higher rate of return than programming the Commission may deem less meritorious.)

36. Perhaps the Commission would seek to avoid such formalities, and simply put in place some vague guidelines upon which future Commissions are supposed to determine what is "reasonable" and what is not. But what would the guidelines say? Upon what rational basis would the Commission propose to distinguish between the "reasonable" and the "unreasonable"? All of the questions noted above, and dozens more, would simply rear their heads in the context of individual proceedings; the Commission could *delay* coming to terms with these untenable issues, but *it could not avoid them* forever.

37. However such a system was implemented, it would inevitably introduce significant distortions into the market for television programming. While the precise nature of such distortions are impossible to predict *ex ante* (and, indeed, would be difficult to quantify even *ex post*), it is a virtual certainty that, by replacing market-based prices with prices effectively set by government *fiat*, the new system will prevent economic resources from flowing to their highest-valued uses.

38. All of the above considerations are multiplied in complexity and impact if the Commission were to seek to impose asymmetric regulation, i.e., to impose one set of regulations on "small" cable operators and a different one on "large" ones. As my analysis of the competitive situations faced by different cable operators presented above demonstrates, it is far from clear that there is *any* correlation between system size (or other definable characteristics),

on the one hand, and competitive conditions involving programming negotiations. In the end, it is no more likely that the Commission could devise a rational basis for asymmetric regulation than that it could, having done so, implement the price controls necessary to make it work.

39. The only thing more obvious than the high costs and economic distortions that would result from adopting Regulation Advocates' proposals is that nothing in this proceeding has prepared the Commission to engage in such an exercise. Regulation Advocates have failed to establish that there is a market failure of any sort associated with the wholesale market for television programming. They have failed even more completely to present the Commission with a workable alternative to the current system.

## IV. CONCLUSION

40. Regulation Advocates have neither demonstrated the need for regulation nor presented the Commission with a workable scheme for implementing their proposals. By adopting their proposals, the Commission would surely reduce economic welfare significantly, though the precise magnitude of the welfare loss would likely never be known.