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

In the Matter of	)	
	)	
Implementation of the Cable Television Consumer Protection and Competition Act of 1992	)	MB Docket No. 07-29
	)	
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

<u>REPLY COMMENTS OF DISCOVERY COMMUNICATIONS, LLC</u>

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TABLE OF CONTENTS

Page

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

Implementation of the Cable Television Consumer Protection and Competition Act of 1992; Development of Competition and Diversity In Video Programming Distribution:	)	MB Docket No. 07-29
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

REPLY COMMENTS OF DISCOVERY COMMUNICATIONS, LLC

Discovery Communications, LLC ("Discovery") submits these reply comments in the above-captioned proceeding. Discovery is an innovator and a leader in developing original niche and educational programming. Its networks are widely recognized to offer premium programming that nurtures curiosity and creativity. Discovery's family of U.S. networks includes: Discovery Channel, TLC, Animal Planet, The Science Channel, Discovery Health, Discovery Kids, Investigation Discovery, Military Channel, Discovery Home,[1/] HD Theater, FitTV, Discovery en Español, and Discovery Familia.

INTRODUCTION AND SUMMARY

Suggestions that the Commission has the authority to regulate the prices, terms and conditions on which programming services are sold to distributors -- or that there is any need for the Commission to undertake such regulation -- are deeply flawed.

1/ Discovery Home will be relaunched as "Planet Green" in 2008 and will focus on green lifestyle programming, as part of Discovery's commitment to be the most comprehensive and trusted global resource for celebrating, preserving and protecting the planet.

There is no legal authority for the Commission to carry out the extreme interference in programmer-distributor carriage relationships sought by a few self-serving commenters hoping for government leverage in their carriage negotiations. More importantly, however, there is no need. The initial comments confirm the existence of a vibrant, dynamic marketplace in which programming networks are offered for sale in a variety of ways, both in a bundle and on a standalone basis, allowing distributors and programmers to tailor each agreement to their individual needs and priorities. The sale of popular programming networks is not "tied" to the sale of other networks, nor would it be desirable or economically feasible for programmers to undertake such a strategy.

Significantly, the premise that the bundling of programming networks is harmful to competition is wholly erroneous. As the attached economic analysis of Mr. Jonathan M. Orszag demonstrates, bundled offerings provide numerous pro-competitive effects, including substantial processing and legal costs savings to all involved parties and more opportunities for give and take in the negotiating process, which help keep the cost of programming down at the wholesale and retail levels. Allowing programmers to offer their programming on a bundled basis also gives newer networks a greater chance of survival and consumers greater programming variety. In contrast, mandating the sale of programming networks on a standalone basis at a "reasonable" price would lead to substantial new burdens for all involved, require constant government oversight and involvement, and would likely result in less investment and innovation in programming.

Simply put, suggestions that programming services should be required to be sold at the wholesale level on an individual basis to distributors is nothing more than an attempt to lay the foundation for required *a la carte* offerings at the retail level. For all the reasons Discovery and scores of other programming services have opposed an *a la carte* regime in the past -- that it would make Discovery's networks more expensive for consumers, force some networks off the air, and result in a dramatic decrease in programming quality, an outcome utterly inconsistent with consumer welfare -- Discovery equally opposes interference with the wholesale market for the sale of programming.

Programming options today are exploding. There are more programming networks than ever before -- over 565 at last count[2/] -- serving all populations, including diverse and niche audiences that were previously neglected. There are new and exciting means and platforms for delivering that programming -- from the Internet, to mobile devices, to iPods. In short, the market is working. Regulatory policy should seek to encourage this developing innovation and competition, not stifle it with regulations that will be outdated by the time they are final.

I. THE COMMISSION DOES NOT HAVE LEGAL AUTHORITY TO UNDERTAKE EXTENSIVE REGULATION OF THE TERMS AND CONDITIONS OF SALE OF VIDEO PROGRAMMING

It is indisputable that the Commission must have jurisdiction under the Communications Act before it can regulate the terms and conditions of sale of video programming, including whether or not a programming service is offered for sale in combination with other programming services or whether the price for such programming is reasonable.[3/] But as the initial commenters observe, the Commission has no such authority to prohibit the bundled sale of

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2/ *See* http://www.ncta.com/Statistic/Statistic/NationalVideoProgramming.aspx (there were 565 national programming networks as of 2006).

3/ *Lyng v. Payne*, 476 U.S. 926, 937 (1986) ("An agency's power is no greater than that delegated to it by Congress."); *Friends of the Crystal River v. EPA*, 36 F.3d 1073, 1080 (6th Cir. 1994) ("Agencies are creatures of statutory authority. Thus, they have no power to act . . . unless and until Congress confers power upon them."); *see* Fox Comments at 33.

programming or regulate the wholesale rates at which programming is offered.[4/] The Communications Act provides no express or implied authority for regulating packaging agreements, and Commission precedent consistently argues against asserting such jurisdiction.

The Commission's suggested assertion of authority over the bundled sale of programming[5/] pursuant to Section 628(b) is misguided. Section 628(b) only gives the Commission authority to regulate conduct that has the effect of preventing or significantly hindering vertically integrated programming from being carried on competitors' distribution systems. It does not give the Commission blanket authority to broadly interfere in private negotiations to regulate terms and conditions of wholesale programming carriage agreements regardless of whether such terms have the effect of barring access to programming.[6/] The bundled sale of programming services raises no concerns about the ability to *access* programming, notwithstanding the Commission's superficial equating of bundled offers with "tying."[7/]

Not only does the plain language of Section 628(b) prohibit the Commission from seeking to regulate carriage agreements where access to the programming clearly has not been prevented, but to do so would directly contravene Congressional intent to allow programmers flexibility in how to offer their programming. Far from intending to prohibit programming bundling, Congress, understanding that packaging agreements are appropriate and pro-

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4/ *See, e.g.*, Viacom Comments at 24-32; Fox Comments at 33-38.

5/ *Implementation of the Cable Television Consumer Protection and Competition Act of 1992*, MB Docket No. 07-29, Report and Order and Notice of Proposed Rulemaking, FCC 07-69 ¶¶ 129-32 (rel. Oct. 1, 2007) ("*NPRM*").

6/ *See* Viacom Comments at 28; Fox Comments at 33-35.

7/ *See* NBC Universal Comments at 34; Viacom Comments at 16-17; Time Warner Comments at 21; Disney Comments at 42-43, 49-52.

competitive, specifically chose to allow such practices.[8] As numerous commenters observe, the Communications Act "expressly *permits* the establishment of different prices, terms and conditions to take into account differences in the cost of creation, sale, delivery or transmission of satellite cable programming or economies of scale, cost savings or other economic benefits attributable to the number of subscribers served by the MVPD."[9]

The Commission has no authority to bar what the Act expressly allows.[10] This is true regardless of whether the Commission believes that it "clearly" reserved the right to adopt unlimited rules addressing packaging arrangements in its prior orders.[11] Indeed, the apparently boundless nature of the asserted authority itself proves that the Commission reaches too far.[12]

Discovery further agrees with commenters that neither the Commission's ancillary jurisdiction nor any other provision of the Communications Act the Commission cites provides it the authority to regulate packaging agreements.[13] Section 4(i), for example, by its own terms cannot support regulating programming agreements because such authority applies only when

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8/ *See* Time Warner Comments at 20; Viacom Comments at 33-34.

9/ NBC Universal Comments at 24-25 (citing 47 U.S.C. § 543(c)(2)(A)) (emphasis in original). *See also* Disney Comments at 6, 10 n.27 ("bundled selling ... expressly was contemplated as an appropriate and pro-competitive practice.").

10/ *Louisiana Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 374-75 (1986).

11/ *NPRM* ¶ 129.

12/ *See West Virginia Univ. Hosps., Inc. v. Casey*, 499 U.S. 83 (1991); *Aid Ass'n for Lutherans v. U.S. Postal Service*, 321 F.3d 1166, 1174-75 (D.C. Cir. 2003); *Railway Labor Executives Association v. National Mediation Board*, 29 F.3d 655, 670-71 (D.C. Cir. 1994). The far-reaching assertions of some commenters that the Commission could regulate every conceivable business practice of a programmer under this assertion of regulatory authority, *see, e.g.,* ACA Comments at 20-26 (advocating that numerous regulatory requirements be imposed under section 628(b)), underscores that this cannot be the correct statutory interpretation; EchoStar Comments at 16-19 (requesting extreme regulation of programming carriage agreements).

13/ Disney Comments at 14 (citing 47 U.S.C. §§ 151, 152; *U.S. v. Southwestern Cable Co.*, 392 U.S. 157 (1968)).

the entity the Commission seeks to regulate is engaged in communications by wire or radio at the time the regulation is applied to the entity, which is clearly not the case.[14/]

Similarly, Section 201(b) is part of the separate title of the Communications Act governing communications common carriers, and it provides no basis for regulating programming agreements.[15/] Section 303(r) of the Act likewise appears in Title III, dealing with radio communications, and so is not at issue here. If Sections 201(b) and 303(r) were meant to confer *general* regulatory jurisdiction over all matters covered by the Act and not merely the matters covered in their respective titles, they would be redundant. This cannot be.[16/] The only reasonable reading of these provisions is that each was meant to grant the FCC authority only with respect to the title of the Act in which they appear.[17/]

Assertion of jurisdiction over wholesale programming arrangements also is inconsistent

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14/ *American Library Association v. FCC*, 406 F.3d 689, 700, 703 (D.C. Cir. 2005); *see* NBC Universal Comments at 25-26; Viacom Comments at 29.

15/ 47 U.S.C. § 201(b); *GTE Services Corp. v. FCC*, 474 F.2d 724, 734 n. 15 (2d Cir. 1974); *see* Viacom Comments at 28.

16/ *Lake Cumberland Trust, Inc. v. EPA*, 954 F.2d 1218, 1222 (6th Cir. 1992) ("Under accepted canons of statutory interpretation, [the court] must interpret statutes as a whole, giving effect to each word and making every effort not to interpret a provision in a manner that renders other provisions of the same statute inconsistent, meaningless or superfluous.").

17/ The remaining asserted bases for jurisdiction are similarly unavailing. Section 601(6) is merely a statement of Congressional purpose that does not constitute an independent source of authority. Moreover, regulating packaging agreements runs directly counter to the section's purpose of minimizing "unnecessary regulation that would impose an undue economic burden on cable systems." 47 U.S.C. § 521(6). If anything, section 601(6) would command that the Commission refrain from regulating packaging agreements. Section 612(g) provides no basis for regulating programming, and in any event, its triggering threshold test has not been met. *See* News Release, Federal Communications Commission, FCC Adopts 13th Annual Report to Congress on Video Competition and Notice of Inquiry for the 14th Annual Report (rel. November 27, 2007). Section 616(a) provides protections for video programmers, not authority for imposing burdens on programmers. NBC Universal Comments at 29 (citing 47 U.S.C. § 536(a)); Viacom Comments at 30. Finally, Section 706, 47 U.S.C. § 157nt(a), addressing broadband deployment, has nothing to do with video programming. In any event, the Commission has acknowledged that Section 706 "does not constitute an independent grant of forbearance authority or of authority to employ other regulating methods." *Deployment of Wireline Services Offering Advanced Telecommunications Capability,* 13 FCC Rcd. 24011, 26044 (1998). *See* Viacom Comments at 31.

with past Commission decisions. In 1998, 2002, and 2004, the Commission declined to broadly interpret Section 628.[18/] Instead, it narrowly interpreted Section 628,[19/] held that antitrust law is as an adequate remedy for any abuses that may exist,[20/] and deferred to Congress the question of whether packaging of programming should be further regulated.[21/] Moreover, the Commission's rules explicitly contemplate that programmers may package programming.[22/] The Commission offers no justification for why it should depart from this sound Commission precedent and departures from precedent of this magnitude require a well-founded reason for change.[23/]

II. THE RECORD DOES NOT DEMONSTRATE ANY NEED TO REGULATE THE SALE OF PROGRAMMING

Even if Section 628(b) could be read to apply to the bundled sale of programming, the comments demonstrate that there is no need for regulation because these agreements do not "hinder significantly" or "prevent" MVPDs from providing satellite cable programming to consumers. To the contrary, programming today is available to MVPDs in a wide variety of

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18/ *See Implementation of the Cable Television Consumer Protection and Competition Act of 1992*, Report and Order, 13 FCC Rcd. 15822, 15856 ¶ 71 (1998) ("Where the record fails to indicate a significant competitive problem, we are reluctant to promulgate general rules prohibiting activity particularly where reasonable issues are raised regarding the scope of the statutory language."); *Implementation of the Cable Television Consumer Protection and Competition Act of 1992*, Report and Order, 17 FCC Rcd. 12124, 12157-58 ¶¶ 71-74 (2002); *General Motors Corporation*, Memorandum Opinion and Order, 19 FCC Rcd. 473, 600 ¶ 291 (2004).

19/ *See Implementation of the Cable Television Consumer Protection and Competition Act of 1992*, Report and Order, 17 FCC Rcd. 12124, 12158 ¶ 73 (2002) (citing H.R. Conf. Rep. 102-862, 102nd Cong., 2nd Sess. 91 (1992)).

20/ *See* Federal Communications Commission, Report on the Packaging and Sale of Video Programming Services to the Public, at 80 (rel. Nov. 18, 2004); *see also* Disney Comments at 42-43.

21/ *See id.*; Federal Communications Commission, Retransmission Consent and Exclusivity Rules: Report to Congress Pursuant to Section 208 of the Satellite Viewer Extension and Reauthorization Act of 2004, at 25 ¶ 45 (rel. Sept. 8, 2005).

22/ *See* 47 C.F.R. § 76.1002(b)(1), Note 2 (discussing "...a distributor's purchase of programming in a package..."); Time Warner Comments at 20.

23/ *See Motor Vehicle Manufacturers Association v. State Farm Mutual Auto Insurance Co.*, 463 U.S. 29, 41-42 (1983) (agency rescission of rule is arbitrary and capricious without sufficient justification).

packaged and standalone offers, so that programmers and distributors may tailor distribution agreements to best reflect their individual needs and priorities.

Programmers' initial comments confirm that programming is being offered in a variety of innovative and pro-competitive ways. Programming channels are widely available on a standalone basis and distributors are not required to carry unwanted programming as a condition of access to the most popular programming.[24/] As Time Warner explains, it is standard practice in the industry for programmers to offer their services both in bundles and individually.[25/]

These statements conform to Discovery's own experience: Despite the overwhelming popularity of Discovery Channel,[26/] Discovery does not condition carriage of Discovery Channel on the carriage of any other Discovery network, including its new and niche networks. In fact, distributors across the country carry Discovery Channel on a standalone basis and no other Discovery-affiliated network.

Allegations that programmers refuse to offer standalone programming on reasonable terms are simply unsubstantiated. And, they are easily disproven: while Discovery Channel

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24/ Fox states that it makes all of its programming channels available on a standalone basis and does not require carriage of its new or niche networks as a condition of purchase of its most popular channels, but that packaging is "overwhelmingly popular among MVPDs." Fox Comments at 19, 21-23. Disney affirms that it does not condition carriage of its most popular networks (*i.e.*, Disney Channel and ESPN) on the carriage of other programming networks. Disney Comments at 43-44. Viacom states that it does not compel distributors to negotiate for carriage of multiple networks. Viacom Comments at 11-14.

25/ Time Warner Comments at 21.

26/ In a November 2007 survey of cable subscribers by Beta Research, Discovery Channel was ranked first in numerous categories, including the percent of total respondents that rated Discovery Channel as important to their enjoyment of cable, Discovery Channel's average perceived value, the percent that mentioned Discovery Channel unaided as among their five favorite channels, and the percent of respondents who had sampled the network in the previous 12 months. In addition, Discovery came in first among non-sports networks for the percent of viewers rating the programming 4 or 5 on a five-point scale. Regarding the percent of total respondents rating Discovery Channel as important to their enjoyment of cable, Discovery Channel ranked first among all of men, women, adults age 18-34, women age 18-34, adults age 18-49, persons with $100,000+ household incomes, persons with children, African Americans, Hispanics and Asians. Beta Research, The Beta Research Cable Subscriber Study – Evaluation of Basic Cable Networks (Nov. 2007).

remains the most widely distributed cable programming network, only one other Discovery-affiliated network (TLC) appears on the list of the top twenty most penetrated networks.[27/] If Discovery Channel refused carriage to distributors that did not agree to carry the other Discovery networks, many of those networks would be expected to appear in the top twenty.

As explained in the accompanying Declaration of Jonathan M. Orszag,[28/] the reality is that it is not economically feasible for most programming networks to withhold the sale of their programming when their affiliated networks are not carried.[29/] As Mr. Orszag explains,

> Any potential concern about the abuse of market power through the tying of desired and undesired programming is completely unwarranted if the programmer lacks significant market power in the provision of video programming. . . the key issue is whether the programmer possesses the type of market power to impel an MVPD to take the tied product in a way that harms competition in a relevant market.[30/]

Mr. Orszag finds that programming networks offered by Discovery simply do not possess that type of market power.[31/] While the FCC has found that even the temporary withdrawal of a broadcast signal can cause subscribers to shift to another MVPD carrying the broadcaster, such that the broadcast signal regains many of the "eyeballs" needed to maintain advertising revenues (and that even the threat of such action is enough to win them a higher "price" for their retransmission consent),[32/] there is no similar upside to withholding programming for cable networks.

27/ SNL Kagan Data Services: Economics of Basic Cable Networks, "Cable Network TV and Multichannel Household Penetration 1997-2006" (2007) (listing Discovery Channel as the most highly penetrated programming network, TLC as the 11th most penetrated programming network).

28/ *See* Attachment A.

29/ Orszag Decl. ¶¶ 22-27; *see* Time Warner Comments at 21; Fox Comments at 20-21; Disney Comments at 37-39.

30/ Orszag Decl. ¶ 22.

31/ *Id.* ¶ 23.

32/ *General Motors Corporation*, 19 FCC Rcd at 567-69 ¶¶ 206-211.

While Discovery's networks are highly valued by subscribers, Mr. Orszag concludes that they do not fall into the "must-have" category.[33/] Even Discovery's most popular channel, Discovery Channel, "typically accounts for only about two percent of total cable channel viewership" and "similar programming is available from competing channels."[34/] As such, "[a]ny attempts by Discovery to charge supracompetitive prices for a standalone Discovery Channel, or to tie the carriage of the Discovery Channel to programming undesired by MVPDs, would likely result in a termination of carriage of Discovery's programming by a large number of MVPDs."[35/]

Consequently, it would not be economic for Discovery to withdraw Discovery Channel from a distributor that would not carry Discovery's other networks. Subscribers would not switch distributors in order to continue watching Discovery Channel and distributors would simply and quickly turn to other similar programming networks, such as National Geographic, History Channel, Sci Fi, or A&E, to fill the void. The loss of carriage fees and advertising revenues would be too significant to allow for such a bargaining strategy.[36/] In fact, Discovery could not risk withdrawing its programming even for a short time, because there would be no guarantee that its viewership would return to its original level once subscribers had turned to other networks.[37/]

Discovery also would face the risk of its programming suppliers, who typically operate

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33/ Orszag Decl. ¶ 26-27.

34/ *Id.* ¶ 23.

35/ *Id.* ¶ 24.

36/ *See id.* ¶¶ 24-25. Moreover, whether or not a programmer is vertically integrated has no effect on this analysis. There is nothing unique about a vertically integrated programmer that allows it to harm competition when it does not possess the market power that would allow it to engage in tying. *See id.* ¶¶ 35-39.

37/ *Id.* ¶ 24.

pursuant to short-term or program-specific agreements, moving their programs to networks that are more widely carried.[38/] This, too, Mr. Orszag concludes, makes it "unlikely that Discovery would engage in the kind of conduct that would risk termination of carriage by MVPDs."[39/] In the absence of any hard evidence that the terms of carriage are resulting in programming being denied to distributors, the Commission should refrain from imposing new regulation.

III. ALLOWING BUNDLING PROMOTES INNOVATION AND PROGRAMMING VARIETY

The initial comments demonstrate that programming today is being widely distributed pursuant to varied innovative agreements and numerous approaches, and that the ability to offer a bundled sale is an important tool for programmers competing for carriage in the increasingly competitive market.[40/] Just as distributors find it important to be able to offer customers the "triple play" of services, programmers need the ability to package their services in the manner most appealing to their customers. As Internet and mobile platforms emerge more fully, this will prove even more true.[41/] In this environment, Mr. Orszag finds numerous pro-competitive effects of allowing programmers to choose the manner in which their programming networks are distributed.

First, programmers package their services in discounted bundles and other combinations to expand distribution of their services in the most efficient and effective manner.[42/] Doing so saves significant processing, negotiating, and legal costs, allowing them to agree to lower

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38/ *Id.* ¶ 25.

39/ *Id.*

40/ Fox Comments at 21-26; Viacom Comments at 9-11; Disney Comments at 45-49.

41/ *See* Disney Comments at 52-54 (describing emerging video programming platforms, including Apple's iTunes, Amazon's Unbox and Qualcomm's MediaFlo Mobile TV).

42/ Orszag Decl. ¶¶ 6-10; *see* Time Warner Comments at 7; Disney Comments at 52-54.

carriage fees. As Mr. Orszag explains, it is far more cost-effective for Discovery to negotiate with an MVPD over the terms of carriage of several of its networks than it is to negotiate each carriage agreement separately.[43/] Moreover, because negotiating costs generally do not depend on the number of subscribers being served by an MVPD, the costs of negotiating carriage agreements separately would be even larger for the smaller MVPDs that would be the supposed beneficiaries of a requirement to negotiate agreements on a standalone basis.[44/]

It is because the benefits of bundling are so widely recognized that the approach is so pervasive in commerce. As Mr. Orszag notes,

> Bundles are not just present in the video programming and MVPD industries but are ubiquitous in just about every segment of the economy. For example, a gym membership offers the use of a bundle of fitness equipment; a new automobile consists of a bundle of various products, such as a radio and CD player; sneakers are both bundled together (right and left) and with shoelaces; a magazine consists of a bundle of articles and pictures; hotels bundle the room with various amenities such as a bed, a television set, and bed linens; restaurants offer bundles that include food, service, and the use of a table, chairs, and table utensils; and a cable channel itself is a bundle of programming shown at different times.[45/]

The Commission itself has recognized the cost and efficiency benefits of bundling, finding that it can be an "efficient distribution mechanism" that can allow consumers to obtain goods and services "more economically than if it were prohibited."[46/] Eliminating bundling as an option would necessarily raise costs, resulting in higher fees for consumers, reduced variety or quality in programming, or a disruption in the delivery of programming.[47/]

43/ Orszag Decl. ¶ 8; Disney Comments at 50-52.

44/ Orszag Decl. ¶ 9; *see* Fox Comments at 16-17; Disney Comments at 52.

45/ Orszag Decl. ¶ 6.

46/ Orszag Decl. ¶ 7 (quoting *Bundling of Cellular Customer Premises Equipment and Cellular Service*, 7 FCC Rcd. 4028, 4035 n.35 (1992)); *see also* Disney Comments at 27-31.

47/ Orszag Decl. ¶ 10-11; *see* Disney Comments at 27 (noting that bundling saves distribution, packaging and transaction costs while increasing reliability for consumers).

Second, offering programming on a bundled basis provides more opportunities for give and take in the negotiating process. The greater number of terms that are on the table, the greater the likelihood that the parties can compromise on some terms (*e.g.*, a less preferred tier for one programming service) in return for a better result (*e.g.*, better price) for another service at issue. Because the parties have more opportunities to balance less preferable terms against more positive outcomes in other areas of the agreement, they can tailor carriage agreement to reflect their specific priorities and circumstances. They are therefore far more likely to reach an agreement than if they had to negotiate individual standalone agreements for the same programming services.[48/] Expanding the likelihood of potential deals gives parties more flexibility to reach agreements to fit their specific, unique circumstances.[49/] Prohibiting that ability would be harmful to both the parties and to consumers, who are best served by allowing flexibility so that they have the greatest likelihood of access to the widest variety of programming.[50/]

Third, allowing programmers to offer their programming on a bundled basis gives newer networks a greater chance of survival and consumers greater programming variety.[51/] While programmers do not have the leverage to obtain carriage of new networks across all distributors' subscribers, bundling allows programmers the opportunity to introduce new programming networks to a small set of subscribers, to allow them to gain some footing in the marketplace.[52/]

48/ Orszag Decl. ¶ 12-14; *see* Fox Comments at 21-26.

49/ *Id.*; *see* Fox Comments at 23.

50/ Orszag Decl. ¶ 14.

51/ *Id.* ¶¶ 5, 21; *see* Viacom Comments at 14-15.

52/ *Id.* at 15.

Because investment is less risky, programming networks have the flexibility to create more innovative service offerings.

Fourth, mandating the sale of programming networks on a standalone basis at a "reasonable" price would lead to substantial new burdens for all involved.[53/] The regulation of market-based relationships is a slippery slope. Because there is always likely to be disagreement between parties about what prices, terms and conditions are "reasonable," a government rule governing the sale of programming inevitably would spur some distributors to urge the Commission to adopt detailed price regulation, negotiating rules, cost studies, and similar inquiries.[54/] Even assuming appropriate regulations could be written -- a highly uncertain assumption in this area of rapid technological change[55/] -- they would still lead to uncertainty as to their actual application. They also would lead to the creation of a new bureaucracy to apply such rules and add layers of additional costs for dealing with the regulations and bureaucracy. The existence of such a scheme would open the door to a constant stream of complaints from distributors dissatisfied with the terms of proposed carriage agreements and using (or threatening to use) Commission involvement as leverage in what should be private business negotiations. Hearing and resolving complaints would tie up scarce government resources and impose substantial uncertainty in the industry.

Moreover, requiring programmers to offer their networks pursuant to particular terms, rates and conditions may lock them into carriage arrangements that prevent them from responding to customers' changing interests and do not reflect marketplace reality. The "value" of a programming network is not static; rather, how it is perceived is a constant function of its

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53/ Orszag Decl. ¶¶ 15-21.

54/ *Id.* ¶ 16.

55/ *Id.* ¶ 17.

latest ratings, the popularity of individual shows, and numerous other largely unpredictable factors. Programmers must be free to market their service in the way that both best accounts for this uncertainty and allows them to differentiate their services as much as possible from the competition, in order to create the fullest development of healthy competition and the greatest consumer benefits.

As Mr. Orszag explains, the end result of a highly regulated environment would be that MVPDs may not carry and programmers may not invest in programming desired by viewers if MVPDs or programmers are not able to earn a minimum viable rate of return.[56/] This would be a "significant step backward for video programming regulatory policy"[57/] at the very time when programming options -- and the means and devices for delivering that programming -- are exploding. Regulatory policy should seek to encourage the innovation and competition that is emerging by allowing market forces to prevail whenever possible.

Finally, ACA's proposal to prohibit programmers from requiring carriage on a specific tier or requiring distribution to a minimum percentage of subscribers[58/] is essentially a proposal to ban volume discounts.[59/] As Mr. Orszag confirms, there is no need to ban volume discounts. To the contrary; "a ban against volume discounts for video programming would harm consumer welfare for a number of reasons."[60/] Their economic benefits are well documented; their prohibition would result in an inefficient allocation of resources; and a ban would inevitably lead to higher costs for most subscribers and a difficult decision by programmers regarding whether

56/ *Id.* ¶¶ 17-18.

57/ *Id.* ¶ 15.

58/ ACA Comments at 22.

59/ Orszag Decl. ¶ 31.

60/ *Id.*

the increased costs justify distribution to smaller MVPDs.[61/] ACA's self-serving and anti-consumer approach should be rejected.

CONCLUSION

The Commission should decline to impose additional regulation on the sale, packaging or pricing of programming networks.

Respectfully submitted,

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61/ *Id.* ¶¶ 32-34. As is the case with bundling, any actual anticompetitive behavior could easily be addressed by existing antitrust laws. *Id.* ¶ 30.

CERTIFICATE OF SERVICE

I, Christopher R. Bjornson, hereby certify that on this 12th day of February 2008, the foregoing Reply Comments of Discovery Communications LLC was filed electronically through the FCC's Electronic Comments Filing System (ECFS) and copies were served on the following as indicated:

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ATTACHMENT A

Before the
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DECLARATION
OF
JONATHAN M. ORSZAG

Table of Contents

I. Qualifications

1. My name is Jonathan Orszag. I am a Senior Managing Director and member of the Executive Committee of Compass Lexecon. My services have been retained by a variety of public-sector entities and private-sector firms ranging from small businesses to Fortune 500 companies. These engagements have involved a wide array of matters, from entertainment and telecommunications issues to issues affecting the sports and retail industries. I have been active in applied analysis of issues affecting the Multichannel Video Programming Distributor ("MVPD") market and have been a consultant to a number of major MVPDs and programming providers. I have testified before administrative agencies, the U.S. Congress, the European Court of First Instance, and other foreign regulatory bodies on a range of issues, including competition policy, industry structure, and fiscal policy.

2. Previously, I served as the Assistant to the U.S. Secretary of Commerce and Director of the Office of Policy and Strategic Planning and as an Economic Policy Advisor on the President's National Economic Council. For my work at the White House, I was presented the Corporation for Enterprise Development's 1999 leadership award for "forging innovative public policies to expand economic opportunity in America."

3. I am a Fellow at the University of Southern California's Center for Communication Law & Policy. I received a M.Sc. from Oxford University, which I

attended as a Marshall Scholar. I graduated *summa cum laude* in economics from Princeton University, was elected to Phi Beta Kappa, and was named to the *USA Today* All-USA Academic Team. In 2004, I was named by the *Global Competition Review* as one of "the world's 40 brightest young antitrust lawyers and economists" in its "40 under 40" survey. In 2006, the *Global Competition Review* named me as one of the world's "Best Young Competition Economists."

II. Introduction

4. In its October 1, 2007 Notice of Proposed Rulemaking, the Federal Communications Commission (the "Commission") discussed concerns raised by small and rural cable operators and other MVPDs about "tying of desired programming with undesired programming."[1] The concerns are related to the assertions by small and rural cable operators that major suppliers of programming tie "undesired" with "desired" programming in licensing negotiations with MVPDs. The Commission sought comments regarding potential regulations that would prohibit such "programming tying arrangements."[2] I have been asked by Discovery Communications, LLC. ("Discovery") to provide an economic analysis of any potential regulations regarding bundled programming deals. I have also been asked to analyze proposals raised by initial filers in this proceeding.[3]

[1] *In the Matter of Review of the Commission's Program Access Rules and Examination of Programming Tying Arrangements*, Notice of Proposed Rulemaking, MB Docket No. 07-198, Released Oct. 1, 2007; Adopted Sept. 11, 2007 ("FCC NPRM").
[2] FCC NPRM at ¶ 1.
[3] See *In the Matter of Review of the Commission's Program Access Rules and Examination of Programming Tying Arrangements*, American Cable Association Comments, January 3, 2008 ("ACA Comments"); as well as comments by Dish Network; Community Broadcasters Association; National

III. Summary of Conclusions

5. Based on my application of economic theory and empirical evidence to the issues of concern, I have reached the following conclusions:

- Unbundling regulation may come in two forms: (1) a prohibition of bundled contracts (*i.e.*, cable programmers would be forced to sell each channel on a standalone basis); and (2) mandating that suppliers of programming offer each channel on a standalone basis for "reasonable" prices in addition to any bundled offers.

- In the absence of evidence of significant market power by programmers, an outright prohibition against all types of bundled contracts would be an extreme policy prescription and overly burdensome. Bundled programming distribution agreements can increase efficiency, decrease costs, enhance program variety, and help to facilitate negotiations.

- Regulations prohibiting all cable programmers from bundling program offerings to MVPDs would harm economic performance, create additional costs to the parties involved in negotiations, and would harm consumers by (a) denying them new programming, which would likely harm program variety; (b) raising the costs of obtaining programming; and (c) potentially causing disruptions in the delivery of desired programming.

Telecommunications Cooperative Association; Organization for the Promotion and Advancement of Small Telecommunications Companies; and Rural Iowa Independent Telephone Association.

- Mandating the sale of standalone channels at "reasonable" prices would be burdensome and akin to price controls. The regulation would likely result in numerous disputes about the definition of "reasonable," which would raise costs for MVPDs and programmers alike. How would it be determined for *every single* cable programming channel whether $0.10 per subscriber, $0.50 per subscriber, $1.00 per subscriber, or $5.00 per subscriber is a "reasonable" price? By creating another avenue for dispute, such a regulation may inhibit, rather than facilitate, negotiations between programmers and MVPDs. Ultimately, in the absence of evidence of the type of market power that can impel an anticompetitive tying arrangement by a cable programmer, regulations that force cable programmers to make "reasonable" standalone offers to MVPDs will harm, rather than promote, competition and will be counter to the interests of consumers.

- Discovery does not possess the type of market power that would allow it to harm competition in any relevant market. In fact, Discovery offers its most popular programming both within a bundle and as a standalone offering. Reflecting the economic benefits from bundling, many MVPDs take the bundled offering of Discovery programming. Regulating these business decisions and imposing a "reasonableness" test regarding the price offered by Discovery for its standalone offering would necessarily harm economic efficiency. Indeed, from an economic perspective, none of the preconditions exist that would suggest that this form of regulation would be appropriate for Discovery – or any other cable programmer who does not possess the type of market power that can harm competition through tying arrangements.

- There are numerous pro-competitive benefits from negotiating programming carriage agreements in bundles rather than as individual standalone agreements:

    - *Negotiating over bundles of programming facilitates agreements.* The ability to negotiate over standalone *or* bundled contracts gives parties more flexibility to reach carriage agreements. Specific bundles may be offered to different MVPDs that fit the needs and circumstances of specific distributors. The flexibility in offering different types of bundles can facilitate negotiations and enable efficient agreements. Importantly, if parties could not negotiate over program bundles, there is an increased likelihood of a breakdown in negotiations over carriage. The effect of such a breakdown is that consumers may not be able to receive highly desired programming. In such a circumstance, consumer welfare would be harmed. Negotiating over program bundles can therefore mitigate the likelihood of such carriage disruptions.
    - *Negotiating over bundled contracts can reduce the legal costs associated with reaching agreements.* Such cost savings are passed onto consumers in terms of lower prices, higher quality programming, or more program variety.
    - *Program bundles can help increase new entry and program variety.* In the absence of the type of market power to impel an MVPD to take tied programming, bundling can help content providers launch new programming channels, thereby increasing program variety. Recent history of the MVPD industry shows high growth in program variety.

- While bundling is generally efficient, under certain circumstances, bundling can be used to further anticompetitive ends. Firms with the type of market power to impel an MVPD to take tied programming maye mploy schemes to take advantage of strength in one market to gain substantial power in another market. However, unless there is a showing that current antitrust laws cannot address in a timely manner any concerns regarding anticompetitive conduct on the part of cable programmers and that new regulations would be an effective prophylactic (which has not been made), new regulation on unbundling of cable programming would be unnecessary and harmful.

- The ACA proposed regulations under which programmers would be compelled to charge every MVPD the same price – that is, the ACA has recommended effectively banning volume discounts in the pricing of cable programming. This type of regulation would either result in (a) higher programming costs for most MVPD consumers or (b) reduced access to programming for some consumers. In either case, it would likely diminish competition among MVPDs and result in detriments to consumer welfare.

- Finally, those commentators who suggest that vertical integration provides a justification for regulation banning bundles or, alternatively, for regulation mandating "reasonable" offers of standalone channels, are raising a red herring. Vertical integration may be a relevant factor if the cable programmer possesses sufficient market power to impel a MVPD to take tied programming. But in the absence of such market power, whether the cable programmer is vertically integrated or not has no effect on the economic impact of bundling.

IV. Prohibition Against Bundled Programming Agreements Would Reduce Efficiency and Harm Consumer Welfare

6. There are often significant efficiency benefits in selling bundles of goods. Bundles are not just present in the video programming and MVPD industries but are ubiquitous in just about every segment of the economy. For example, a gym membership

offers the use of a bundle of fitness equipment; a new automobile consists of a bundle of various products, such as a radio and CD player; sneakers are both bundled together (right and left) and with shoelaces; a magazine consists of a bundle of articles and pictures; hotels bundle the room with various amenities such as a bed, a television set, and bed linens; restaurants offer bundles that include food, service, and the use of a table, chairs, and table utensils; and a cable channel itself is a bundle of programming shown at different times. In theory, such goods or services could be unbundled and offered on an *a la carte* basis. However, most people would agree that compelling sellers via government regulation to offer these services on an *a la carte* basis would make little sense and would not be beneficial to consumers.

7. The Commission has recognized the economic benefits of bundling in competitive markets, noting that "[p]ackaged offerings are commonplace in a variety of industries in which customers can purchase a number of goods in a package at a lower price than the individual goods could be purchased separately."[4] The Commission continued to conclude that bundling can be an "efficient distribution mechanism" and an "efficient promotional mechanism" that can allow consumers to obtain goods and services "more economically than if it were prohibited."[5]

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[4] *S ee Bundling of Cellular Customer Premises Equipment and Cellular Service*, CC Docket No. 91-34, 7 FCC Rcd. 4028, 4035 n. 35 (1992) ("Cellular Bundling Order").

[5] Cellular Bundling Order at 4030-4031. The Department of Justice has reached a similar conclusion. *See, e.g.,* U.S. Department of Justice, "Antitrust Division Submission for OECD Roundtable on Portfolio Effects in Conglomerate Mergers - Range Effects: The United States Perspective," October 12, 2001, available at http://www.usdoj.gov/atr/public/international/9550.htm.

8. The principal reason why bundles are so pervasive in commerce is not the abuse of market power but rather because bundling often saves costs and creates efficiencies. A restaurant could charge customers separately for the use of utensils, but that would introduce additional processing costs for the restaurant and diminish the customer's convenience. The same reasoning applies to programming bundled offers to MVPDs. Offering bundled programming reduces contract negotiation costs for both the suppliers of programming as well as MVPDs. For example, Discovery's channel lineup includes: Discovery Channel, Animal Planet, Discovery Health, Discovery HD Theater, FitTV, Discovery Home, Discovery Kids, Military Channel, The Science Channel, Investigation Discovery, TLC, Discovery en Español, and Discovery Familia. Negotiating separate agreements for the carriage terms for each of the 13 Discovery cable channels would be more costly to both Discovery and the individual MVPDs.

9. Because the costs of negotiating program carriage agreements between a supplier of programming and an MVPD do not generally depend on the number of subscribers served by MVPDs, the costs of negotiating individual standalone programming carriage agreements would be larger (when measured on a per subscriber basis) for smaller MVPDs.

10. One basic implication of economic theory is that higher costs generally lead to a reduced level of output or quality.[6] Some of the higher costs of negotiating standalone channel carriage contracts may be passed to consumers through higher

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[6] Dennis W. Carlton and Jeffrey M. Perloff, 1994. *Modern Industrial Organization*, New York: Harper-Collins.

subscriber fees. Thus, if the suppliers of video programming were prohibited from offering and negotiating over programming bundles, consumers could be harmed by less programming variety, lower quality of programming, and higher prices. As the carriage contract negotiation costs would account for a relatively larger share of total revenues for smaller MVPDs, the reduction in program variety and an increase in costs would be especially pronounced for the subscribers of smaller MVPDs. Thus, a prohibition against bundled programming carriage agreements may actually result in higher consumer welfare losses for the subscribers of smaller MVPDs than for the subscribers of larger MVPDs.

11. Another important efficiency benefit of bundled programming agreements is that bundling of programming increases the chance that the negotiation of agreements would be successful. In many circumstances, parties may be able to agree on a combined bundled deal even if they could not reach agreement on standalone deals.[7] Consider the following example. A programmer owns two cable channels, A and B, that an MVPD wishes to offer to its subscribers. The programmer believes that the fair market value of channels A and B are $1.00 and $0.50 per subscriber per month. The MVPD believes that the fair market value of channels A and B are $1.20 and $0.40 per subscriber per month. If forced to negotiate over the standalone carriage agreements, the programmer and the MVPD would fail to reach agreement for carriage terms for channel B. Failure to reach agreement would be inefficient and would reduce the economic welfare of consumers who would be denied the opportunity to view programming on channel B. However, the programmer and the MVPD could reach agreement when negotiating over

[7] H. Raiffa, 1982. *The Art and Science of Negotiation*, Harvard University Press, Cambridge.

carriage terms for a bundle of channels A and B because the programmer believes that the fair market value for the programming bundle is $1.50 per subscriber per month, and the MVPD believes that the fair market value of the bundle is $1.60. Thus, both would be willing to agree on a deal that charges the MVPD $1.55 per subscriber per month for the right to carry both channels A and B. Failure to reach the terms of carriage agreements can disrupt the distribution of timely programming and result in considerable welfare losses for consumers.[8]

12. As the example above demonstrates, including programming bundles in the set of possible agreements expands the universe of potential carriage agreements. Expanding the universe of potential carriage agreements provides parties with the additional flexibility to reach such agreements that are in their mutual interest. Programmers and MVPDs are not obliged to agree on bundled programming deals, but including such deals in the set of potential agreements would allow the parties to enter into such contracts if doing so makes them both better off. Programmers and MVPDs negotiate terms of carriage that include the programs carried, the price schedules, the subscriber penetration levels or, alternatively, the tiers on which the programs are to be shown, contract durations, advertising slot allocations, and other clauses that specify carriage terms. The negotiations between the programmers and MVPDs may entail a complex process of choosing the terms and conditions that best serve the interests of the

[8] One notable example in which negotiations over the distribution terms of a standalone cable channel failed is when many viewers in the New York City metropolitan area were denied the opportunity to receive telecasts of New York Yankees baseball games when Cablevision and the YES network failed to reach agreement on carriage terms. The recent disputes involving the NFL Network represent another example of the failure to reach carriage terms over a standalone cable channel. To be sure, there have been failures to reach terms over bundled deals as well. The point is that bundles offer more possibilities for agreement.

negotiating parties. For example, programmers and MVPDs may agree on a bundled programming deal for some of the programmer's channels and standalone deals for the others. Thus, expanding the set of potential program carriage deals improves economic efficiency by providing the parties with the flexibility to reach agreements that best fit their specific circumstances, thereby enabling the parties to construct more advantageous and cost-effective agreements. Likewise, prohibition against such bundled programming carriage agreements reduces economic efficiency and makes both programmer and MVPDs worse off than under an unrestricted agreement regime.

13. Discovery's programming carriage agreements with MVPDs provide a useful illustration of the flexibility in structuring carriage agreements. Although many of Discovery's agreements with MVPDs are for a bundle of two or more of Discovery's channels, some MVPDs distribute *only* Discovery's most popular network, the Discovery Channel. These instances are consistent with the view that the suppliers of programming and MVPDs structure deals that fit the parties' specific circumstances and are in the mutual interest of the parties.

14. In a dynamic marketplace, such as the distribution of video programming, it is essential to provide parties the flexibility to reach a broad variety of distribution agreements that enhance economic efficiency and fit the parties' specific circumstances. A prohibition against certain kinds of distribution agreements would be a fairly blunt and ineffective instrument of regulatory policy. The long-term interests of consumers would

be best served without such broad prohibitions against bundled programming carriage deals.

V. Mandating "Reasonable" Standalone Cable Channel Offers Is *Not* in the Interest of Consumers

15. Regulations that would force the suppliers of programming to offer to MVPDs standalone cable channels on "reasonable" terms would be a significant step backward for video programming regulatory policy. Such regulations regarding "reasonable" unbundled offers would effectively reintroduce price controls for video programming. The policy would introduce burdensome and unnecessary regulations to all parts of an industry that has made tremendous progress in enhancing competition, expanding variety, and improving the quality of video programming. Mandating "reasonable" standalone offers would effectively introduce a public utility style of regulation *even to cable programmers who possess none of the types of market power that would allow them to use the tying of programming to harm competition or consumers*. Economic studies of past attempts to regulate cable prices charged to consumers demonstrate the difficulties with, and drawbacks of, such regulations.[9] There is no reason to believe that the regulations under consideration in this proceeding would be any more effective when applied to prices charged by cable programming channels.

16. The reason why mandating the sale of standalone cable channels at reasonable terms and conditions is so problematic, from an economic perspective, is

[9] See Crandall, R., and H. Furchtgott-Roth (1996): *Cable TV: Regulation or Competition?* Brookings Institution; Crawford, G. (2000): The Impact of the 1992 Cable Act on Household Demand and Welfare," *RAND Journal of Economics*, 31(3), 422-449; and Crawford, G. "Cable Regulation in the Satellite Era," September 5, 2006 (available at http://www.u.arizona.edu/~gsc818/research/)

because what is "reasonable" to an MVPD may not be reasonable to the suppliers of programming. There is likely to be some disagreement between parties about what constitutes "reasonable" terms and conditions. Programmers would argue that reasonable prices enable risk-adjusted recovery of the investment in programming. MVPDs and other interested parties may argue that different standards for "reasonable" prices should apply. The Commission may need to undertake extensive studies of an appropriate standard for judging "reasonable" offers *for every cable programming channel.* The debate about the appropriate standard for determining "reasonable" prices is likely to spur extensive regulatory hearings and litigation. Even if the parties and the Commission agree on an appropriate standard for judging standalone offers, programmers may face significant compliance costs as well as the costs of potential litigation to resolve disputes. Such costs are likely to be passed onto consumers in the form of higher user fees. Under a regulation that mandates "reasonable" standalone offers, programmers may also have perverse incentives to increase the costs of producing programming to justify higher standalone cable channel prices. Thus, the regulation may result in higher production costs without a corresponding increase in quality, thus diminishing the economic efficiency of the production of programming.

17. Video programming prices is a key input in the efficient allocation of economic resources. MVPDs make their supply and investment decisions based, in part, on their costs of video programming. For instance, an MVPD may decide whether to expand its channel capacity based on its costs of video programming and the subscribers' demand for such programming. It is therefore imperative that the prices paid by MVPDs

for video programming reflect marketplace supply and demand conditions. Historically, regulatory agencies have not been particularly adept at mandating price levels that raise economic efficiency or accurately reflect the marketplace demand and supply conditions.[10] Further, the production and distribution of video programming occur in a dynamic and rapidly evolving marketplace. For example, the introduction of HD programming has the potential to revolutionize the video programming industry. To maintain efficient video programming prices, regulations on reasonable standalone offers must also quickly evolve to keep pace with the evolution of the industry. Regulatory agencies are not particularly well-suited to make rapid changes in regulatory policy in response to market conditions. Thus, regulations that mandate "reasonable" standalone offers are likely to result in significant losses of economic efficiency that would manifest themselves in higher prices faced by consumers, smaller variety of programming, and diminished quality of programming.

18. If mandated "reasonable" standalone prices were deemed to be too low by cable programmers, such regulations may simply result in a lower quality of programming. Suppose that regulations mandate a standalone price for ESPN of $2.50 per subscriber per month. (I understand that the average license fee for ESPN is much higher than $2.50 per subscriber per month.[11]) Disney's response to such pricing regulation may involve reducing the amount of expensive live programming (*e.g.*, airing

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[10] See, for example, Steven A. Morrison and Clifford Winston, *The Economic Effects of Airline Deregulation.* Brookings, Washington DC, 1986; and Clifford Winston, "U.S. Industry Adjustment to Economic Deregulation" *Journal of Economic Perspectives*, Vol. 12, No. 3. (Summer, 1998), pp. 89-110.

[11] According to Kagan, ESPN's average license fee in 2005 was $2.59 per subscriber per month. *See* 2005 SNL Kagan Economics of Basic Cable. This figure likely understates the true average rate for two reasons: (1) ESPN's license fee has increased since 2005, and (2) I understand that Kagan's estimates of average license fees often understate actual fees.

of NFL games) because its "reasonable" subscription fee would not allow it to earn the type of economic return necessary to justify large investments in programming.[12] Similarly, if mandated "reasonable" standalone prices were deemed to be too high by an MVPD, the MVPD may choose to either not carry some programming that it otherwise would have carried or some consumers would be priced out of their extant programming package option. Thus, if the government were to set the "reasonable" price at the wrong level, consumers would be harmed because they would get access to less programming content.

19. An alternative approach for compelling unbundled cable channel offers would be to introduce pricing regulations that impose a maximum bundled discount. For example, regulations may mandate that the standalone price of a channel be no more than 20 percent higher than the price of the channel when offered as part of a bundle. However, this type of regulation would also be ineffective in encouraging *a la carte* cable channel purchases by MVPDs. Suppliers of cable programming could offer list prices that comply with these pricing rules but then negotiate lower prices for bundles of channels. Regulators seeking to stop such practices would have no choice but to impose strict rules on the negotiating process or, alternatively, to participate in the negotiations between programmers and MVPDs. But this kind of regulatory involvement in private negotiations between the suppliers of video programming and MVPDs would harm economic efficiency because it would impede the search for mutually beneficial deals,

[12] The Commission could also mandate that there is no degradation in programming quality, but such regulatory intervention in the content of cable programming would be difficult, if not impossible, to administer.

introduce excessive rigidity in the negotiations, and impose significant regulatory compliance costs.

20. However, even if standalone pricing rules succeeded in promoting *a la carte* channel purchases by MVPDs, the regulations would likely lead to *higher* programming prices for both MVPDs and consumers. Consider the following example. Suppose that a supplier of video programming sold two cable channels in a bundle for $2, where the bundled price of channel A is $1.50 and channel B is $0.50. Suppose regulations on standalone pricings imposed a maximum bundling discount of 20 percent, and under this pricing scheme half the MVPDs would purchase the entire bundle and the other half of MVPDs would only purchase channel A.[13] To maintain the same level of revenue as before the standalone pricing regulations, the supplier would need to charge a price of $1.94 for cable channel A and $2.06 for the two-channel bundle.[14] This example illustrates the point that if suppliers of programming are compelled by regulations to increase *a la carte* channel sales, they would seek higher prices for their programming. Without the higher prices, cable programming channels would likely need to eliminate some programming, which would result in less variety and programming content available to consumers.

21. Another adverse consequence of standalone pricing regulation would be to impede launches of new cable channels. Launches of new channels would be held up because of the additional hurdle of determining the regulatory-compliant pricing for a

[13] In this hypothetical example, all MVPDs are of equal size.
[14] The example assumes that the relative prices of channels A and B will be maintained post-regulation.

new channel when the demand (both short and long-term) for the channel is difficult to gauge. Standalone cable channel price regulation would also hinder new channel launches if regulations would restrict the pricing incentives that programmers could offer MVPDs to assist in the launch of the channels.

VI. Discovery Does Not Possess The Type of Market Power That Would Allow It to Harm Competition in Any Relevant Market

22. Any potential concern about the abuse of market power through tying of desired and undesired programming is completely unwarranted if the programmer lacks significant market power in the provision of video programming; in the instant case, the key issue is whether the programmer possesses the type of market power to impel an MVPD to take the tied product in a way that harms competition in a relevant market. A theoretical argument could be made that a supplier of video programming may be in a position to harm competition through "anticompetitive tying" by employing schemes to taking advantage of its position in one market to create substantial market power in another market.[15] However, significant market power is a necessary (though not a sufficient) condition for any harm to competition. Thus, the absence of significant market power should obviate any concerns about harm to competition.

23. An examination of the cable programming channel sector indicates that Discovery does not possess the type of market power to enable it to harm competition in the provision of video programming. Discovery operates in a highly competitive

[15] Michael D. Whinston, 1990. "Tying, Foreclosure, and Exclusion." *American Economic Review*. 80:4, pp. 837–59; and Barry Nalebuff,2 004. "Bundling as an Entry Barrier," *Quarterly Journal of Economics*.119:1, pp. 159-187.

environment where it faces competition from a large number of suppliers of video programming. Discovery's most widely available cable channel, the Discovery Channel, typically accounts for only about two percent of total cable channel viewership.[16] Although the Discovery Channel has highly acclaimed programming and a loyal base of viewers, similar programming is available from competing channels, such as the National Geographic channel, the History Channel, the SciFi Channel, the A&E network, as well as programming that is often available on general interest channels.

24. Any attempts by Discovery to charge supracompetitive prices for a standalone Discovery Channel, or to tie the carriage of the Discovery Channel to programming undesired by MVPDs, would likely result in a termination of carriage of Discovery's programming by a large number of MVPDs. Such loss of carriage would lead to a substantial reduction in licensing and advertising revenues.[17] Many viewers and MVPDs would simply shift to channels with similar programming, such as the National Geographic Channel, the History Channel, the SciFi Channel, the A&E network, as well as to general interest programming channels. Discovery may also face additional long-lasting harm since some viewers may not return to Discovery channels even after MVPDs resume carriage of Discovery's programming.

25. Discovery does not have long-term contracts with highly recognized sports or entertainment content providers. Instead, Discovery relies to a large extent on a continual stream of original quality programming. If MVPDs terminate the carriage of

[16] Based on 2003 average total-day ratings reported in 2005 SNL Kagan Economics of Basic Cable, p. 40.
[17] Discovery Holding Company 10-K, February 28, 2007, p. I-15.

Discovery's programming, the producers of Discovery's original programming would also likely shift to other channels. Such loss of original programming would also cause a long-term reduction in the viewership of Discovery's programming. Thus, it is unlikely that Discovery would engage in the kind of conduct that would risk termination of carriage by MVPDs.

26. In past rulings, the Commission has been concerned about the potential for the abuse of market power by broadcast or cable channels with so-called "must have" programming.[18] The term "must have" programming has been used by the Commission in connection with programming for which there are no good substitutes, such as regional sports networks (RSN) or major broadcast networks.[19] The Commission has reached "must have" determinations for RSNs or major broadcast networks based on empirical evidence: The Commission has found, based in part on empirical evidence provided by me and a colleague, that if an MVPD does not carry an RSN or a major broadcast network, a substantial number of subscribers switch from this MVPD to an MVPD that does carry these channels.[20] The logic is that if a substantial number of subscribers would switch from one MVPD to another to continue to have access to certain programming, that programming channel possesses a significant amount of leverage over the MVPD. My examination of the video programming industry suggests Discovery does not possess the type of "must have" programming that could cause a substantial

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[18] *Implementation of the Cable Television Consumer Protection and Competition Act of 1992*, 17 FCC Rcd 12125 (2002) (*"Program Access Order"*).at ¶4.
[19] *Id.* at ¶ 34. I should note that the term "must have" has no precise definition in economics.
[20] Federal Communications Commission, "Subject to Conditions, Commission Approves Transaction Between General Motors Corporation, Hughes Electronics Corporation and The News Corporation Limited," Public Notice, FCC 03-328 (released December 19, 2003) at 10.

enough number of subscribers to switch MVPDs to maintain access to its programming.[21] One reason why a substantial number of subscribers would not switch MVPDs to maintain access to Discovery channels is that consumers have access to other channels that offer similar programming.[22]

27. One measure of the degree to which Discovery's programming is not "must have" is the size of Discovery channels' average license fees relative to license fees of other cable channels. If a channel is "must have" programming, it is able to command a relatively high license fee because the carriage of such programming is especially valuable to MVPDs. Therefore, a low relative license fee is an indication that a channel is not "must have." The 2005 Kagan Economics of Basic Cable Networks Report shows that, in 2005, ESPN had an average license fee that was about 11 times higher than the Discovery Channel's average license fee and about 16 times higher than TLC's average license fee.[23] Likewise, the 2005 Kagan Report shows that TNT, which carries live telecasts of NBA games, had an average license fee in 2005 that was about three times higher than the Discovery Channel's average license fee and about five times higher than TLC's average license fee.

[21] While I have not examined the "must have" nature of other cable programming channels (except RSNs), there are presumably numerous other cable channels that are similarly situated to the Discovery channels and lack the type of market power necessary to harm competition through the use of tying arrangements.

[22] Such networks include the National Geographic channel, the History Channel, the SciFi Channel, and the A&E Network.

[23] 2005 SNL Kagan Economics of Basic Cable. I understand that the average license revenues reported by Kagan may misstate the true average license revenues for basic cable channels. However, the biases in the Kagan data are unlikely to affect significantly the thrust of the point about *relative* sizes of license revenues for ESPN, TNT, the Discovery Channel and TLC.

28. These results suggest that Discovery has relatively little bargaining power when negotiating carriage contracts with MVPDs and that, were an MVPD to drop carriage of Discovery's programming, the subscriber losses for MVPDs would not be large enough to provide Discovery the type of market power to allow it to tie undesired programming to its desired programming. If a substantial number of subscribers would switch from one MVPD to another to maintain access to the Discovery Channel – or other Discovery-owned channels – Discovery would presumably have substantial negotiating leverage over the MVPD and this would have been reflected in much higher average license fees. Thus, the magnitudes of average license fees for Discovery's channels are consistent with the view that MVPDs have access to channels with programming that is similar to the type of programming shown on Discovery's channels. The foregoing discussion suggests that the programming offered by Discovery's channels could not be described as "must have."

29. Given Discovery's market position, the availability of other cable channels with similar programming, the power of major MVPDs to shift to alternative content providers, and the magnitude of potential loss as a result of the termination of carriage, it is highly unlikely that Discovery possesses the type of market power that would allow it to harm competition in any relevant market. From an economic perspective, none of the preconditions exist that would suggest that the types of regulation under consideration would be appropriate for Discovery – or any other similarly situated cable programmer.

VII. Current Antitrust Laws Can Address Concerns Regarding Anticompetitive Conduct on the Part of Cable Programmers

30. As discussed above, the economic literature concludes that bundling is generally efficient, though under certain circumstances, it can be used to further anticompetitive ends.[24] However, the current antitrust laws can address concerns regarding any anticompetitive conduct on the part of cable programmers. As there are existing laws and regulations to address any tying conduct of concern for consumers of video programming, the benefits of any new regulation against any anticompetitive tying conduct are likely to be quite limited. However, in the absence of the type of market power that can harm competition, such new regulations would introduce considerable social cost as discussed above. In this instance, the blunt instrument of a per se rule banning bundling or a rule mandating "reasonable" standalone prices would impose substantially more costs than benefits. Thus, new regulations, like the ones being considered, would likely lead to a decrease, rather than an increase, in consumer and social welfare.

VIII. Regulation Proposals That Prohibit Volume Discounts for Video Programming Would Reduce Efficiency and Harm Consumers

31. The ACA proposed regulations that would prohibit programmers from requiring carriage on specific tier levels or requiring distribution to a minimum percentage of subscribers served by an MVPD.[25] The only feasible implementation of such a regulation would be a prohibition against all agreements that offer discounts to

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[24] Also see Adams, William James and Janet Yellen, "Commodity Bundling and the Burden of Monopoly," *The Quarterly Journal of Economics*, Vol. 90, No. 3 (Aug 1976), pp. 475-298; and R. Preston McAfee, John McMillan, and Michael D. Whinston, "Multiproduct Monopoly, Commodity Bundling, and Correlation of Values," *The Quarterly Journal of Economics*,Vo l. 104, No. 2 (May 1989), pp. 371-383.

[25] ACA Comments at 22.

MVPDs for reaching target carriage levels (or, alternatively, impose penalties for not reaching the target carriage levels). Thus, the ACA's proposal would effectively ban all volume discounts for cable programming channel pricing. However, a ban against volume discounts for video programming would harm consumer welfare for a number of reasons, as explained below.

32. Volume discounts on video programming are consistent with sound economics regarding the costs and benefits to programmers of additional distribution. Since the cost to the programmer of providing cable programming to each MVPD is effectively identical regardless of the size of the MVPD and the benefits of reaching deals with the largest MVPDs are greatest (in terms of subscriber reach and the increased potential for advertising revenue), an economically efficient pricing structure for video programming would necessarily entail volume discounts. Such pricing reflects the costs *and* benefits of providing video programming to MVPDs. Consequently, a prohibition against volume discounts would result in an inefficient allocation of resources.

33. In response to a ban on volume discounts, programmers could react in one of two basic ways.[26] First, programmers could increase the price of cable channels to consumers served by large MVPDs who serve the majority of households. If the programmer tries to capture the same amount of revenue as compared to a world where the programmer offers volume discounts, the programmer would need to raise prices to

[26] There are a myriad of potential combinations of responses, but these two basic responses highlight the constraint facing programmers in a world where they are barred from offering volume discounts.

large MVPDs (in order to lower prices for small MVPDs).[27] That is, the single price offered to all MVPDs would be an average of the prices in the market today. Thus, in the name of equity, the ACA proposal may lead to higher prices for a significant number of MVPD subscribers. Second, in reaction to a ban on volume discounting, instead of raising prices to larger MVPDs, programmers may just decide not to sell cable programming to smaller MVPDs. That is, since cable programmers would be compelled to offer the same price to small and large MVPDs, they may find that the benefit of selling programming to small MVPDs (where the price is the same as paid by large MVPDs) does not outweigh the costs of engaging in negotiations with small MVPDs. In that case, the ACA proposal would backfire on its members: in the name of equity on prices, it may just result in the lack of carriage of cable programming channels. In either case, the concept of banning volume discounts necessarily harms consumers, either by causing average prices to raise or by denying certain consumers access.

34. A ban on volume discounts would also have another negative effect on pricing in the market: it would eliminate an important dimension of competition among MVPDs. Right now, MVPDs compete for the lowest price they can seek from the programmer. If all MVPDs were mandated to pay the same price – because non-cost-based discounts would be banned – the ability for a single MVPD to negotiate for a better deal would be significantly impeded. An example may illuminate this issue. Suppose a cable company currently pays a certain price per subscriber per month for a channel. With a ban on volume discounts in place for every channel, the cost to the channel

[27] ACA seems to believe that programmers will simply lower prices for all MVPDs. In such a scenario, the programmer would earn less revenue, which would result in the programmer having less resources to invest in programming quality, which would also harm consumers.

owners of reducing the price for this cable company is not just the loss in revenue for subscribers of this company, but also the reduction in revenue from every other MVPD. As a result, it would be more difficult for any MVPD to negotiate a lower price, to the detriment of its consumers. A ban on volume discounts would also increase the transparency of wholesale cable pricing, which would tend to chill competition in this instance. Consequently, the proposed regulation would likely lead to even higher cable channel prices.

IX. Vertical Integration Between A Programmer and MVPD Does Not Necessitate Additional Regulation on Unbundling of Programming

35. Some parties have suggested that bundling of video programming should receive additional regulatory scrutiny when the supplier of programming engaged in bundling is vertically integrated with an MVPD.[28]

36. Economic theory has developed a variety of models to examine the impact on competition from vertical integration.[29] One set of models suggests that vertical integration can never serve an anticompetitive purpose.[30] Another set of models has shown that this so-called "Chicago" view of vertical integration is misguided and that vertical integration can be used for anticompetitive purposes. Where the literature agrees, however, is that if there is a lack of significant market power, the potential for

[28] *See, e.g.,* Broadband Service Providers Association Comments at 15-16 and Coalition for Competitive Access to Content Comments at 8-10.

[29] These models typically assume "upstream" firms supply an input to "downstream" firms who subsequently sell a good to consumers. In this case, the programmer is the upstream firm and the MVPD provider is the downstream firm.

[30] Two often cited sources are Robert H. Bork, *The Antitrust Paradox*, (New York: Basic Books, 1978) and Richard A. Posner, *Antitrust Law*, (Chicago: University of Chicago Press, 1976).

anticompetitive effects is minimal. As described above, Discovery does not possess the type of market power that would allow it to harm competition. Therefore, whether it is - or is not - vertically integrated is irrelevant for assessing whether the proposed regulations are sound public policy.

37. A simple example may help to highlight this point. An anticompetitive tying scenario may be illustrated as follows: a cable programmer owns a channel (A) with the type of market power to impel MVPD I to take its tied programming (B). It then uses that market power to foreclose competition in the market including channel B; that is, it leverages its market power with channel A to harm competition in the market with channel B. How does vertical integration fit into this illustration? If the cable programmer also has an ownership stake in MVPD II, a competitor of the MVPD I, the cable programmer has some additional negotiating leverage: if MVPD I does not take the tied products, some subscribers of MVPD I will switch to MVPD II. The vertical integration does not increase the incentive to engage in foreclosure; it simply increases the ability to do so. In this stylized example, the vertical integration, thus, increases the negotiating leverage of the cable programmer, thereby facilitating the hypothetical anticompetitive conduct.

38. However, a necessary (but not sufficient) condition of this stylized anticompetitive story is that the cable programmer has the type of market power to impel MVPD I to take its tied programming. In the absence of such market power, the story falls apart. If the cable programmer tried to force MVPD I to take channel B, MVPD I

could reject the offer and there would be no harm to competition in the market with channel B. MVPD I could easily reject the offer because, as defined above, the lack of market power to impel an MVPD to take tied programming means that few subscribers would switch from MVPD I to MVPD II if MVPD I did not carry channel A.

39. Thus, given the absence of evidence of significant market power, vertical integration neither changes the incentive or the ability to engage in anticompetitive conduct. As a result, in the absence of significant market power, vertical integration is not a justification for the types of regulation under consideration in this proceeding.

X. Conclusion

40. In the absence of evidence of the type of market power necessary to impel MVPDs to take tied programming, an outright prohibition against all types of bundled contracts would be an extreme policy prescription and overly burdensome. In cases where there is evidence of significant market power, there would need to be a showing that current antitrust laws cannot address in a timely manner any concerns regarding anticompetitive conduct on the part of cable programmers and that new regulations would be an effective prophylactic; neither case has been made in this proceeding.

41. Bundled programming distribution agreements can increase efficiency, decrease costs, enhance program variety, and help to facilitate negotiations. Similarly, in the absence of evidence of significant market power, mandating the sale of standalone channels at "reasonable" prices would be burdensome and akin to price controls. The

regulation would likely result in numerous disputes about the definition of "reasonable", which would raise costs for MVPDs and programmers alike. The government is not well positioned to determine for *every single* cable programming channel whether $0.10 per subscriber, $0.50 per subscriber, $1.00 per subscriber, or $5.00 per subscriber is a "reasonable" price. By creating another avenue for dispute, such a regulation may inhibit, rather than facilitate, negotiations between programmers and MVPDs. Therefore, the regulations under consideration regarding mandatory unbundling are not in the public interest.

I declare under penalty of perjury that the foregoing is true and correct.

Executed on February 12, 2008.

Jonathan M. Orszag