cable

National Cable & Telecommunications Association
25 Massachusetts Avenue, NW – Suite 100
Washington, DC 20001
(202) 222-2300

www.ncta.com

Neal M. Goldberg
Vice President and General Counsel

(202) 222-2445
(202) 222-2446 Fax

December 16, 2009

Mr. Blair Levin
Executive Director
Omnibus Broadband Initiative
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Re: Comments – NBP Public Notice #26; GN Docket Nos. 09-47, 09-51, 09-137(A National Broadband Plan for Our Future)

MB Docket No. 07-269 (Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming)

Dear Mr. Levin:

I am writing on behalf of the National Cable & Telecommunications Association ("NCTA") in response to the above-referenced Public Notice on spectrum usage as well as the recent exchange of correspondence you have had with the National Association of Broadcasters ("NAB") on related issues. In that correspondence, you linked questions about the potential reallocation of broadcast spectrum for wireless broadband use to questions about the effect on consumers of retransmission consent negotiations between broadcasters and multichannel video programming distributors ("MVPDs") such as cable and phone companies and Direct Broadcast Satellite ("DBS") providers. In particular, according to news reports, you apparently asked the NAB to "1) explain what studies or other support NAB had for asserting that over-the-air signals were a governor on cable and satellite pricing, and 2) provide [the NAB's] reaction to the alternate view that retrans[mission consent]fees increase the cost of MVPD service to consumers because they boost MVPD costs, which are then passed along to the consumer."[1]

Because these questions about retransmission consent have been raised in the context of discussions about the reallocation of spectrum, we are taking this opportunity to provide information about the effect of the current retransmission consent regime on consumers so that it might be weighed in the balance as the Commission considers spectrum usage issues. Common sense dictates that increased fees cable operators and other MVPDs pay local broadcasters for retransmission consent will inevitably increase the cost of MVPD service to consumers. Of

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[1] John Eggerton, "Levin Seeks More Clarification From NAB," Broadcasting & Cable Online, November 19, 2009, *available at* http://www.broadcastingcable.com/article/389927-Levin_Seeks_More_Clarification_From_NAB.php.

equal significance are other consumer harms that arise from the current retransmission consent regime such as the disruption of consumer viewing when retransmission negotiations fail.

But common sense will only take you so far when the Commission, Congress and the courts demand fact-based, data-driven conclusions. Therefore, to provide the Commission the type of hard facts and rigorous analysis it needs to draw conclusions on the issues you raised with the NAB about retransmission consent and that may be relevant to the inquiry regarding spectrum usage, we are submitting herewith a recently completed economic study addressing those issues.

The economic study entitled "An Economic Analysis of Consumer Harm from the Current Retransmission Consent Regime" was prepared by Jonathan Orszag, Michael Katz and Theresa Sullivan. It was commissioned by NCTA, DIRECTV, Inc., and DISH Network "to assess the consumer welfare effects of the retransmission consent system" and concludes that "[t]he market conditions that gave rise to the retransmission consent requirement no longer exist, and consumers are being harmed by the bargaining power imbalance that has emerged."[2] In particular, the Orszag Study observes that:

> The video programming marketplace has changed dramatically in the 17 years since [Congress mandated retransmission consent in 1992], but retransmission consent has not. Perhaps the biggest change in the marketplace has been the dramatic and continuing increase in competition resulting from the entry of new providers of MVPD services. The dynamic nature of the marketplace and static nature of retransmission consent regulation raise an important question of whether that regulatory framework developed nearly two decades ago promotes consumer welfare and efficiency today.[3]

In answering that question, the Orszag Study "concludes that the extant system significantly harms consumer welfare through higher subscription fees and the periodic (and to consumers, unpredictable) loss of access to retransmitted broadcast signals."[4] Of particular relevance to the question you have asked NAB to address, the Orszag Study finds that:

- *Local broadcasters retain their historic position as the exclusive providers of uniquely attractive network and syndicated programs in their local markets.* Broadcasters continue to have the type of mass appeal programming that the FCC has held is sufficiently compelling to cause consumers to switch MVPDs if the content is unavailable on their MVPD. Specifically, the FCC and others have found that when one MVPD does not offer a popular broadcast station, a significant number of viewers will switch to rival MVPDs to obtain access to

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2 Jonathan Orszag, Michael L. Katz, Theresa Sullivan, "An Economic Analysis of Consumer Harm from the Current Retransmission Consent Regime," November 12, 2009, at 3-4 ("Orszag Study").

3 Orszag Study at 1, ¶ 1.

4 *Id.* at ¶ 2.

that station's unique content. Thus, although there are many more programming channels today than in the early 1990s, the FCC has concluded that "the signals of local television broadcast stations are without close substitutes." [5]

- *The increase in MVPD costs due to retransmission consent results in higher subscription charges and lower consumer welfare.* The ability of broadcasters to extract large and growing cash payments has driven up MVPDs' costs of providing service. These higher costs predictably result in higher subscription fees to consumers and/or reduced MVPD efforts to attract new consumers by offering high-quality services. *The higher retail prices triggered by retransmission fees directly harm consumers and are flatly inconsistent with the Congress's intent that retransmission consent fees not significantly elevate the prices that consumers pay for MVPD services.*[6]

- *Under the current retransmission consent regime, bargaining between broadcasters and MVPDs sometimes breaks down, resulting in consumer harm when broadcasters withdraw their signal.* There have been several instances in which MVPDs have been unable to offer consumers access to local broadcast stations due to bargaining impasses. These bargaining breakdowns have adversely affected hundreds of thousands of MVPD subscribers. When broadcasters withdraw retransmission rights and a station goes "dark" on a cable, satellite, or phone company video service, subscribers to that service suffer from the loss of, or degraded access to, the station's programming. Such interruptions are sporadic, hard to anticipate, and reduce the quality of the subscriber's experience.[7]

- The lack of close substitutes raises an important issue of policy enforcement when broadcasters enter into Local Marketing Agreements (LMAs) or any other form of agreement under which stations in the same DMA jointly negotiate for retransmission consent compensation. *To the extent that broadcast stations entering into LMAs are substitutes from the perspective of MVPDs, such joint negotiations eliminate competition and raise the stations' bargaining power, which will result in higher fees and consumer harm.*[8]

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5 *See id*. at 26-27 ¶ 38 *quoting General Motors Corporation and Hughes Electronics Corporation, Transferors, and The News Corporation, Limited¸ Transferee*, 19 FCC Rcd 473, 565 ¶ 202 (2004).

6 *See id.* at 3.

7 *See id.* at 4.

8 *See id.* at 27 ¶ 39.

The Orszag study provides hard data demonstrating what common sense would predict: Local broadcaster retransmission consent demands result in higher costs and other harms to consumers. We urge the Commission to take this data into account in examining its options not only with respect to the National Broadband Plan but in other areas where it can ameliorate some of the harms from the current flawed retransmission consent regime.

I hope this material is responsive to some of the concerns you have raised in your correspondence with the National Association of Broadcasters and the issues that are being addressed in response to BNP PN #26. I am also filing this letter and the Orszag Study for inclusion in the record of the Commission's pending video competition proceeding in which NCTA has raised similar issues.[9] If you need any additional information, please contact me.

Sincerely,

/s/ Neal M. Goldberg

Neal M. Goldberg

cc: Marlene H. Dortch (via ECFS)
Phil Belleria
Marcia Glauberman

Attachment

[9] *See* Further Reply Comments of the National Cable & Telecommunications Association, MB Docket No. 07-269 (filed August 28, 2009).

AN ECONOMIC ANALYSIS OF CONSUMER HARM FROM THE CURRENT RETRANSMISSION CONSENT REGIME

– by –

Michael L. Katz
Jonathan Orszag
Theresa Sullivan

November 12, 2009

ABOUT THIS STUDY

This study was commissioned by the National Cable & Telecommunications Association, DIRECTV, and DISH Network to assess the consumer welfare effects of the retransmission consent system. The views and opinions expressed in this study are solely those of the authors and do not necessarily reflect the views and opinions of the National Cable & Telecommunications Association, its members, DIRECTV, DISH Network, or any of the organizations with which the authors are or have previously been associated.

Michael L. Katz (mlkatzconsulting@yahoo.com) holds the Sarin Chair in Strategy and Leadership at the University of California, Berkeley's Haas School of Business. Katz has served as the Deputy Assistant Attorney General for Economic Analysis in the Antitrust Division of the U.S. Department of Justice and as Chief Economist of the Federal Communications Commission.

Jonathan Orszag (jorszag@compasslexecon.com) is a Senior Managing Director of Compass Lexecon, an economic consulting firm. Orszag is also a Fellow at the University of Southern California's Center for Communication Law & Policy and a Senior Fellow at the Center for American Progress. Previously, Orszag served on President Clinton's National Economic Council and as the Assistant to the Secretary of Commerce and Director of the Office of Policy and Strategic Planning.

Theresa Sullivan (tsullivan@compasslexecon.com) is a Senior Vice President at Compass Lexecon and specializes in the application of industrial organization economics to the analysis of antitrust issues. Sullivan has taught at the University of San Francisco and Georgetown University. Sullivan earned her Ph.D. and M.A. in Economics from Georgetown University.

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I. INTRODUCTION AND SUMMARY

1. “Retransmission consent” refers to a set of laws and regulations governing the carriage of local broadcast station signals by multichannel video programming distributors (“MVPDs”), principally cable, satellite, and telephone company video systems. Often referred to as “retrans,” the system was created by the Cable Television Consumer Protection and Competition Act of 1992 (“1992 Cable Act”). The video programming marketplace has changed dramatically in the 17 years since then, but retransmission consent has not. Perhaps the biggest change in the marketplace has been the dramatic and continuing increase in competition resulting from the entry of new providers of MVPD services. The dynamic nature of the marketplace and static nature of retransmission consent regulation raise an important question of whether that regulatory framework developed nearly two decades ago promotes consumer welfare and efficiency today.

2. This white paper presents an economic analysis of this question and concludes that the extant system significantly harms consumer welfare through higher subscription fees and the periodic (and to consumers, unpredictable) loss of access to retransmitted broadcast signals. Indeed, we estimate that the first effect alone (*i.e.,* higher prices) drives as many as 2.3 million households to forgo the benefits of MVPD services.

3. Briefly, our findings are the following:

- *Broadcasters benefit from the retransmission of their signals by MVPDs.* Local broadcasters tend to pursue a business model based primarily on advertising: broadcasters use programming to attract viewers and charge advertisers for access to those viewers. By increasing the number of viewers that a station reaches, retransmission by MVPDs increases the commercial value of the broadcast station’s product: advertising.

- *The benefits of retransmission to broadcasters are so significant that when the right to demand retransmission was threatened by court decisions, broadcasters sought and obtained legislation that allowed them to force MVPDs to retransmit broadcast programming.* For many years, the Federal Communications Commission's ("FCC") must-carry regulation granted broadcasters the right to demand carriage on cable systems. When these must-carry regulations were overturned by the courts, the Congress reinstated them as part of the 1992 Cable Act.

- *Provisions of the 1992 Cable Act granted broadcast station owners a new right to demand compensation from MVPDs that wanted to retransmit broadcast signals*. At the same time that it reinstated must carry, the Congress gave broadcasters the choice between demanding carriage by cable operators under must carry or seeking in-kind or cash compensation through commercial bargaining under retransmission consent. A central component of the retransmission consent system of regulation is that a broadcast station can refuse to allow retransmission of its signal by an MVPD in the absence of a carriage agreement between the station owner and MVPD.

- *Retransmission consent significantly shifted bargaining power toward broadcasters*. Prior to the imposition of retransmission consent regulation, an MVPD (typically a cable system) could retransmit a local broadcaster's signal without permission. Hence, the MVPD had no incentive to provide any sort of compensation to the broadcaster (beyond the value of the larger audience, discussed above). Once the retransmission consent regulation was in place, a broadcaster whose programming was valued by an MVPD could refuse to allow retransmission unless granted compensation. Those broadcasters with valuable programming demanded and received compensation in various forms, including cash and/or carriage of other programming networks in which they had financial interests. On the other hand, broadcasters with less desirable programming can and do demand carriage under must carry, which forces MVPDs to provide valuable services for which they receive no compensation.

- *There has been a dramatic increase in competition among MVPDs since the retransmission consent system was created in 1992.* In 1992, 96 percent of MVPDs' subscribers received service from a cable company and there was typically a single cable provider in each local area. Moreover, first-generation satellite MVPDs did not offer local broadcast signals. Today, direct broadcast satellite ("DBS") service providers offer local signals and, as of June 2009, DBS accounted for 32 percent of all MVPD subscribers. In addition, local telephone companies have quickly gained significant MVPD market share in areas where they provide competing video services. Today, only six of the ten largest MVPDs (as measured by subscribers) are traditional cable companies.

- *The growth in MVPD competition has shifted the balance of negotiating power towards broadcasters in a way not anticipated by the 1992 Cable Act.* An MVPD that fails to obtain carriage of leading broadcast networks is at a significant competitive disadvantage relative to its MVPD rivals serving the same area. An MVPD's refusal to meet a broadcaster's compensation demands can result in the loss of carriage rights and, consequently, a very significant reduction in consumer demand for the MVPD's service as consumers turn to MVPD competitors that have carriage rights.

- *Broadcasters have successfully demanded dramatically increased cash compensation.* Broadcasters use their bargaining power to demand both in-kind and cash payments from MVPDs. In-kind payments typically take the form of MVPD agreements to carry additional networks owned by broadcasters. In-kind payments by cable operators were prevalent in the earlier years of retransmission consent, but cash payments to broadcasters have recently jumped as cable operators have begun paying cash retransmission fees. DBS providers tend to pay cash for retransmission consent and have done so since they first introduced local broadcast station service starting in the late 1990s. Industry analyst SNL Kagan estimates that cash payments grew from $215 million in 2006 to $739 million in 2009.[1] Cash payments are expected to continue to grow even more over the next few years, to $1.6 billion in 2015.[2]

- *The increase in MVPD costs due to retransmission consent results in higher subscription charges and lower consumer welfare.* The ability of broadcasters to extract large and growing cash payments has driven up MVPDs' costs of providing service. These higher costs predictably result in higher subscription fees to consumers and/or reduced MVPD efforts to attract new consumers by offering high-quality services. The higher retail prices triggered by retransmission fees directly harm consumers and are flatly inconsistent with the Congress's intent that retransmission consent fees not significantly elevate the prices that consumers pay for MVPD services.

- *As many as 2.3 million households forgo subscribing to MVPD services as a result of cash payments for retransmission consent.* Calculations based on publicly available data indicate that between 630,000 and 2.3 million fewer households currently subscribe to an MVPD service than would in the absence of retransmission consent payments. This reduction in output is not the result of a consumer-friendly policy.

- *If the current system is not reformed, as many as 1.9 million additional households will forgo subscribing to MVPD services by 2015.* Industry analysts project that cash payments for retransmission consent will continue to rise dramatically if the system is not reformed. The increase in retransmission fees will trigger MVPD price increases that will further harm consumer welfare and reduce MVPD subscribership.

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[1] SNL Kagan, "Broadcast retrans fees on track to break $1 bil. by 2011," *Broadcast Investor: Deals & Finance*, June 30, 2009.

[2] *Id.*

- *Under the current retransmission consent regime, bargaining between broadcasters and MVPDs sometimes breaks down, resulting in consumer harm when broadcasters withdraw their signal.* There have been several instances in which MVPDs have been unable to offer consumers access to local broadcast stations due to bargaining impasses. These bargaining breakdowns have adversely affected hundreds of thousands of MVPD subscribers. When broadcasters withdraw retransmission rights and a station goes "dark" on a cable, satellite, or phone company video service, subscribers to that service suffer from the loss of, or degraded access to, the station's programming. Such interruptions are sporadic, hard to anticipate, and reduce the quality of the subscriber's experience. We are not aware of comprehensive data on such bargaining breakdowns. It therefore is impossible to draw firm conclusions about a trend in such events. Nonetheless, our review of the data strongly suggests that the number of bargaining breakdowns resulting in a station's going "dark" was significantly higher in the second half of this decade as compared to the second half of the 1990s.
- *In order to protect consumer welfare and enhance efficiency, the Congress and the FCC should review the rules under which broadcasters' content is redistributed over cable, satellite, and phone company video services and evaluate whether an alternative system would increase consumer welfare.* The market conditions that gave rise to the retransmission consent requirement no longer exist, and consumers are being harmed by the bargaining power imbalance that has emerged.

4. The remainder of this report explains these conclusions in greater depth and provides details of the facts and analyses supporting them.

II. BACKGROUND

5. This section provides historical context and a summary of the relevant legislation and regulations. Our analysis focuses on the consumer-welfare effects of retransmission consent. We do not consider the economic welfare of the parties directly involved in retransmission consent bargaining: broadcasters and MVPDs. Nor do we consider the consumer-welfare effects of public policies outside of retransmission consent. Consequently, we do not address the welfare implications of several public policies that substantially benefit broadcasters, such as free spectrum licenses worth tens of billions of dollars and the public expenditure of over a billion dollars to subsidize the transition to digital broadcasting.

A. REGULATORY HISTORY

6. The laws and regulations governing the carriage of broadcast station signals on MVPDs have evolved over several decades. Cable television, the first type of MVPD, originated in the late 1940s and early 1950s as a means of improving and extending the availability of broadcast television stations in areas with limited access to over-the-air signals. As cable subscribership grew in the 1960s, broadcasters demanded and received the right to be carried on cable systems serving their local area ("must carry"). By the 1980s, cable had grown into a platform for delivering not just broadcast programming but other programming networks (*e.g.*, ESPN, TNT, and CNN).

7. After the then-existing must carry rules were struck down by the U.S. Court of Appeals for the District of Columbia Circuit as a violation of the First Amendment, the Congress in 1992 enacted a law that allowed broadcast stations to choose between demanding carriage (without compensation) under must carry or demanding compensation for carriage through the "retransmission consent" process, where the broadcast station negotiates with an MVPD for compensation (*i.e.*, in-kind or cash payments) in exchange for the MVPD's carrying (retransmitting) its broadcast signal.[3]

8. The Congress enacted retransmission consent at a time when cable was the predominant form of MVPD service available.[4] The Congress intended the retransmission

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[3] The 1992 Cable Act gave broadcast stations the right to negotiate retransmission consent with MVPDs. The Satellite Home Viewer Improvement Act of 1999, Pub. L. No. 106-113, 113 Stat. 1501, 1501A-526 to 1501A-545 (November 29, 1999) ("SHVIA"), gave broadcasters the further right to demand carriage from a satellite provider in any market in which that satellite provider elected to retransmit any local broadcast signals.

[4] S. Rep. No. 92, 102d Cong., 1st Sess. 1 (1991), LEXSEE 102 S RPT 92, (hereinafter, "Senate Report") at 35.

consent rules to correct a "distortion in the video marketplace which threaten[ed] the future of over-the-air broadcasting."[5] The Congress concluded that there was an imbalance of power in favor of cable operators that benefited from receiving and using broadcast signals for free while also providing competing programming.[6] According to the Congress, this competitive imbalance was caused by "[t]he … demise of local television, the growth of the cable industry, and the fact that *no effective competition to local cable systems has developed* in the interim."[7]

9. Because the Congress wanted to "establish a marketplace for the disposition of the rights to retransmit broadcast signals," not to "dictate the outcome," it left MVPDs and broadcasters to conduct and settle negotiations over retransmission rights between themselves.[8] The Congress believed that, because both received benefits from retransmission, a broadcaster and a cable system would have "incentives … to come to mutually beneficial arrangements."[9]

10. The Congress also recognized, however, that large retransmission consent fees could harm consumers by raising cable rates. Hence, the Congress directed the FCC to establish

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5 *Id.*

6 *Id*. In the absence of retransmission consent regulation, a broadcaster is unable to block retransmission of its signal and is therefore unlikely to be able to negotiate positive fees for its signal. When its signal is retransmitted by an MVPD, however, a broadcaster receives the benefit of distribution to a greater number of consumers: namely, an increase in the value of the broadcaster's advertising slots.

7 *Senate Report* at 44.

8 *Senate Report* at 28.

9 Federal Communications Commission, "Memorandum Opinion And Order," *In the Matter of Implementation of the Cable Television Consumer Protection and Competition Act of 1992*, MM Docket No. 92-259, rel. November 4, 1994 (hereinafter, "Broadcast Signal Carriage Reconsideration Order"), ¶ 115.

retransmission consent regulations that took into account "the impact that the grant of retransmission consent by television stations may have on the rates for the basic service tier" and "ensure that the regulations . . . do not conflict with the Commission's obligation . . . to ensure that the rates for the basic service tier are reasonable."[10] The Congress expected that cable rates would not be unreasonably affected because it anticipated that broadcasters' demands for compensation would be modest, noting that because "broadcasters also benefit from being carried on cable systems… many broadcasters may determine that the benefits of carriage are themselves sufficient compensation for the use of their signal by a cable system."[11]

B. THE CURRENT MUST CARRY/RETRANSMISSION CONSENT REGIME

11. Local broadcast stations continue to enjoy the right either to demand carriage or to withhold carriage rights from an MVPD unless and until the MVPD agrees to compensate the broadcaster for that right. Broadcasters make a new election for must carry or retransmission consent every three years.[12] Exclusive retransmission contracts with a single MVPD are

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[10] 47 U.S.C. § 325(b)(3)(A).

[11] *See Senate Report* at 35-36.

[12] 47 U.S.C. §§ 325, 328, 534; 47 C.F.R. §§ 76.56, 76.64. The most recent election deadline was October 1, 2008 for the period 2009-2011.

prohibited,[13] and MVPDs and television broadcast stations must negotiate for retransmission consent in good faith.[14]

12. There are some differences in broadcasters' carriage rights with respect to carriage on cable systems[15] and satellite systems.[16] For example, although cable operators are required to carry each local station electing must-carry in each market, satellite carriers are subject to a "carry one, carry all" rule. Under this rule, satellite providers can choose not to carry any local stations in a market. If a satellite provider chooses to carry *any* local broadcast station in a market, however, it must carry the signal of *all* local stations electing must carry in that market.[17]

13. Another difference between the rules for cable and satellite providers concerns the set of subscribers to which local broadcast retransmission must be provided. In markets in which the FCC has not found that a cable operator is subject to effective competition, the cable

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13 47 C.F.R. § 76.64(l). Broadcasters are not required to sign contracts with any particular MVPD, however. Consequently, a broadcaster could have *de facto* exclusivity by taking a tough bargaining position with selected MVPDs, provided that the broadcaster did not violate its duty to negotiate in good faith.

14 47 C.F.R. § 76.65.

15 Telephone company MVPDs are cable operators, and we therefore, unless otherwise indicated, use "cable operators" to refer to both traditional cable operators and phone companies.

16 Pub. L. No. 106-113, 113 Stat. 1501, 1999; Pub. L. No. 108-447, 118 Stat. 2809, 2004; Federal Communications Commission, "Retransmission Consent and Exclusivity Rules: Report to Congress pursuant to Section 208 of the Satellite Home Viewer Extension and Reauthorization Act of 2004," (hereinafter "SHVERA Report"), September 8, 2005, ¶ 13-16.

17 47 U.S.C. § 338(a)(l); 47 C.F.R. § 76.66(b). The "carry one, carry all" provision applies only to those stations for which the satellite provider can obtain consent. A broadcast station that withholds its signal cannot prevent a satellite provider from carrying other local broadcast stations.

operator must carry retransmission consent stations on the basic tier, and all cable subscribers are obligated by law to buy this tier (the "must buy" requirement) as a condition of receiving any other tier of programming or to purchase any other programming service.[18] Satellite providers are not subject to the "must buy" requirement,[19] but more recently they nonetheless have packaged their offerings so that the vast majority of subscribers in markets in which they offer local stations have access to them.

14. Yet another difference between cable and satellite concerns the ability to import out-of-market, or "distant," broadcast signals as an alternative to the local broadcast signal.[20] Restrictions on such importation, as well as contractual restrictions in network affiliation agreements, affect negotiations between broadcasters and MVPDs by limiting an MVPD's options for obtaining access to network programming. FCC rules generally require cable operators to black out, on demand, the signal of a distant station within a limited geographic "zone of protection" when that station is broadcasting network and other programming for which a local station has contractually obtained exclusive territorial rights, even if the operator is not carrying the local station.[21] The Copyright and Communications Acts create a

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18 47 U.S.C. § 543(b)(7)(A).

19 47 C.F.R. §§ 76.901 and 76.920.

20 For these purposes, a "distant signal" is generally one that originates outside of a local DMA. *See* 47 U.S.C. § 339(a)(1)(A) (defining distant signal carriage as carriage to "any household not located within the local market[]" of the station in question); 47 U.S.C. § 339(d) (incorporating by reference definition of local market contained in 17 U.S.C. § 122(j)).

21 47 C.F.R. §§ 76.92-95 (cable network non-duplication rules); §§ 76.101-110 (cable syndicated program exclusivity rules); §§ 76.120-125 (satellite network non-duplication and syndicated program exclusivity rules requiring blackout of nationally distributed superstations, but not other stations). In certain instances where two stations both qualify as "local," the territorial exclusivity rules may give one of the stations blackout protection against the other. There are certain exceptions for the importation of distant signals. 47 U.S.C. § 339(a)(2). In addition, both satellite and cable providers may carry (subject to obtaining retransmission consent) the

parallel, but separate, regime for satellite. Satellite carriers can import distant network signals only to households that cannot receive a same-network, over-the-air local signal of sufficient intensity.[22] Moreover, satellite carriers are generally not allowed to offer a distant signal to new subscribers in any market in which they provide local broadcast signals.[23] In addition, most broadcast networks do not affiliate with more than one local station per market and the terms of affiliation between the broadcast station and broadcast network often bar the station from granting retransmission consent for out-of-market carriage. These rules and contractual restrictions not only prevent MVPDs from offering two stations with duplicative programming in a single local area but also limit the MVPD's options if it cannot reach agreement with a local broadcast station. In cases in which the MVPD cannot reach a retransmission consent agreement with a local network affiliate, the MVPD cannot obtain access to and rebroadcast an affiliate from the same or a distant geographic area. These features eliminate any competition among affiliates of a given broadcast television network when negotiating with MVPDs regarding retransmission rights.

15. The retransmission consent regime the Congress has developed is very different from the approach used to compensate copyright owners whose works are shown on MVPD systems. Cable and satellite companies offering video services pay a compulsory copyright royalty fee to retransmit programming carried on distant signals. The Congress concluded that, in a local market, copyright holders are already fully compensated by advertisers and by

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signals of distant stations to any subscriber in a community where the distant station has been deemed by the FCC to be "significantly viewed." (47 C.F.R. § 76.54.)

22 17 U.S.C. § 119(d)(10).

23 17 U.S.C. § 119(a)(4)(B)-(D); 47 U.S.C. § 339(a)(2)(B)-(D).

local broadcasters who air their programming, and no further compensation by so-called secondary distributors, such as cable and satellite companies, is warranted.[24] Retransmission consent, in contrast, allows broadcasters to seek compensation from MVPDs for distribution of their station signals within the same local communities the broadcasters serve with an over-the-air signal.

III. THE ECONOMICS OF RETRANSMISSION CONSENT NEGOTIATIONS

16. The economic analysis of bargaining identifies factors that influence the outcome of negotiations. As will be discussed in this section, one of the most important factors is the extent to which each side of the bargain faces competition from other firms selling similar products or services.

17. Consider a negotiation between an MVPD and a broadcast station owner regarding the former's retransmission of the latter's signal. In order to apply the economic analysis of bargaining, we first clarify the subject of the parties' negotiations. The retransmission of the broadcaster's signal over the MVPD's system creates a valuable service to which both sides of the negotiation contribute and from which both potentially benefit. The station owner contributes the signal, and the MVPD contributes its distribution system. The extended

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24 *See* H.R. Rep. No. 1476, 94th Cong., 2d Sess. 90 (1976) ("The [Conference] Committee determined . . . that there was no evidence that the retransmission of 'local' broadcast signals by a cable operator threatens the existing market for copyright program owners . . . . For these reasons, the Committee has concluded that the copyright liability of cable television systems under the compulsory license should be limited to the retransmission of distant . . . programming.") Cable operators must, however, pay a "minimum fee" even if they do not retransmit any distant signals, purportedly to cover the "copyright clearance function for content carried by local television stations." *See* Register of Copyrights, "Satellite Home Viewer Extension and Reauthorization Act, Section 109 Report," June 30, 2008, at 4 fn.3, *available at* www.copyright.gov/docs/section109/, *site visited* November 6, 2009. *See also* 17 U.S.C. § 122(c) (providing royalty-free license for satellite retransmission of local signals).

distribution of the broadcaster's programming resulting from the combination of the broadcaster's signal and the MVPD's system creates incremental profits derived from additional advertising fees and subscriber fees.[25]

18. If a station owner has elected retransmission consent (rather than must carry), then the broadcaster's signal will be combined with the MVPD's distribution system if and only if both parties voluntarily agree to that arrangement.[26] Thus, an agreement will be reached only if each side finds that agreement to be in its commercial self interest. A negotiation over retransmission rights can thus be thought of as a negotiation over *how to divide the pool of incremental profits created by the retransmission of the broadcaster's signal to the MVPD's subscribers*.[27]

19. Now consider factors that influence how the broadcaster and MVPD divide the pool of incremental profits. Under mainstream economic theories of bargaining, the nature of the agreement that is reached between two parties depends on how the parties would fare if they failed to reach an agreement. The reason for this is that, in determining how hard to bargain,

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[25] The broadcaster can collect additional advertising revenues because its programming is viewed by a larger number of consumers. The MVPD can collect additional subscription fees because it now offers a more attractive channel line up. In addition, the MVPD may attract a larger number of subscribers, which can increase its advertising revenues derived from other programming.

[26] If the broadcaster elects must-carry treatment, then the MVPD is forced to retransmit the broadcaster's signal whether it wants to or not. In this case, incremental profits may still be created, but each party keeps that part of the incremental profit that it receives directly from advertisers or subscribers. In other words, any incremental advertising profits earned by the broadcaster stay with the broadcaster, and any incremental subscriber or advertising profits earned by the MVPD stay with the MVPD.

[27] Bargaining situations are commonly described as negotiations to divide some fixed amount of surplus. *See, e.g.*, Ariel Rubinstein (1982), "Perfect Equilibrium in a Bargaining Model," *Econometrica*, **50**(1): 97-109.

each party takes into account the fact that strong demands might lead to a failure to reach agreement.[28] More specifically, the nature of the agreement that is reached depends on the parties' "disagreement points."[29] A party's disagreement point corresponds to the payoffs (*e.g.*, profits) that the party obtains while the parties are negotiating but have not yet reached an agreement.[30] Until a retransmission agreement is reached, neither the broadcaster nor

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28 The consequences of disagreement matter even if the bargaining parties never actually walk away from each other because even the potential consequences of failing to reach an agreement will affect negotiating behavior. *See, e.g.*, Ken Binmore, Ariel Rubinstein, and Asher Wolinsky (1986), "The Nash Bargaining Solution in Economic Modelling," *The RAND Journal of Economics*, **17**(2): 176-188.

The relevance of this point for retransmission consent negotiations has been noted by the FCC:

> Local broadcast station programming is highly valued by consumers, and entry into the broadcast station market is difficult… At the outset, we agree with commenters who contend that carriage of local television broadcast station signals is critical to MVPD offerings… As commenters have correctly observed, the ability of a television broadcast to threaten to withhold its signal, even if it does not actually do so, changes its bargaining position with respect to MVPDs....

(Memorandum Opinion and Order, *In the Matter of General Motors Corporation and Hughes Electronics Corporation, Transferors and The News Corporation Limited, Transferee, for Authority to Transfer Control*, FCC 03-330, rel. January 14, 2004 (hereinafter, "News Corp Order"), ¶¶ 201, 202, 204.)

29 In some institutional settings, the outcome of bargaining can also depend on the parties' "outside options." A party's outside option corresponds to the payoff that it would receive if it were irrevocably to break off the bargaining and pursue some other option. Outside options generally are not relevant in the current economic environment in which retransmission consent negotiations take place because neither side can commit to walking away from the negotiations permanently; exclusive retransmission consent contracts are banned (*see* 47 U.S.C. § 325(b)(3)(C)(ii); 47 C.F.R. § 76.64(*l*)).

For an influential discussion of this distinction (between disagreement points and outside options) and its significance for bargaining, *see* Ken Binmore, Ariel Rubinstein, and Asher Wolinsky (1986), "The Nash Bargaining Solution in Economic Modelling," *The RAND Journal of Economics*, **17**(2):176-188. *See also*, Y. Stephen Chiu and B. Rachel Yang (1999), "The Outside Option, Threat Point, and Nash Bargaining Solution," *Economics Letters,* **62**(2):181-188.

30 "Disagreement points" are sometimes referred to as "threat points." This terminology can be misleading because the parties do not explicitly threaten anything. The "threat point" language is a holdover from Nash's cooperative theory of bargaining, which can be shown to correspond to the predictions of non-cooperative (or game-theoretic) models of bargaining.

MVPD receives the incremental advertising and subscription revenues that the combination of the broadcaster's signal and the MVPD's distribution system could generate.[31] The resulting profit levels constitute the two parties' disagreement points.

20. Clearly, it would be economically irrational for either party to accept an agreement that resulted in profits for that party that were lower than its disagreement point—that party would be better off without such an agreement. Thus, the negotiations will be over how the two parties divide the gains from working together. That is, under the negotiated agreement, each party will receive an amount equal to its disagreement profits plus some share of the gains from cooperation. Under standard economic models of bargaining, those shares are driven by the relative bargaining abilities of the two parties, as well as their relative bargaining costs or costs of waiting.

21. Applying these economic concepts to retransmission consent negotiations, consider first a negotiation over retransmission rights when there is only one MVPD with which a station negotiates in a particular market, *i.e.*, no other cable, satellite, or phone company MVPD operates in the same market. In order to understand the likely outcome of the bargaining, we need to know the levels of each party's revenues and costs if the MVPD retransmits the broadcaster's signal and if it does not. These data will tell us the parties' disagreement points and their incremental gains from reaching an agreement.

See John Nash (1950), "The Bargaining Problem," *Econometrica*, **18**(2): 155-62; and Ken Binmore, Ariel Rubinstein, and Asher Wolinsky (1986), "The Nash Bargaining Solution in Economic Modelling," *The RAND Journal of Economics*, **17**(2): 176-188.

31 There is a complication introduced by the fact that the parties reach repeated agreements over time. The disagreement point corresponds to the outcome when the previous agreement has expired and a later one has not yet been reached.

22. It is instructive to consider a hypothetical, numerical example. Suppose that each party's gross profits (*i.e.*, revenues minus costs not taking into account any retransmission fees) are as follows:

	Broadcaster	**MVPD**
No retransmission	**10**	**10**
Retransmission	**12**	**14**

Notice that retransmission of the broadcaster's signal generates incremental profits of $6 million per year by generating additional advertising and subscription revenues; $6 million = ($12 million + $14 million) – ($10 million + $10 million). The parties will agree to split that $6 million between them, with the exact split depending on the strength of each side's bargaining power. If the bargaining power of the station owner and the MVPD were evenly balanced, then we would expect that each would receive $3 million of those incremental benefits.[32]

23. Note that, although the two parties split the incremental benefits evenly in this example, this does *not* imply that the MVPD would pay $3 million in retransmission consent fees. The reason is that each party receives directly some of the incremental profit absent any payment between the broadcaster and MVPD. The payment from MVPD to broadcaster in this example is equal to the difference between the portion of the incremental profit earned directly by the broadcaster and half of the total incremental profit.[33] As shown above, in this

[32] For a brief discussion of other asymmetries that can lead to differences in bargaining strength, *see* Binmore, *et al.* at 176-188.

[33] If the broadcaster anticipated that its direct incremental profits from carriage on the MVPD exceeded half of the total incremental profit, it would not opt for retransmission consent;

example, $2 million of the incremental profits went directly to the broadcaster in the form of additional advertising sold by the broadcaster and $4 million went directly to the MVPD in the form of increased subscription fees collected by the MVPD. Hence, the retransmission consent payment would be $1 million: the broadcaster would receive incremental benefits of $3 million = $2 million + $1 million, and the MVPD would receive incremental benefits of $3 million = $4 million – $1 million.

24. Now consider a negotiation over retransmission rights when there is more than one cable, satellite, or other MVPD operating in a particular market. Assume for simplicity that there are two such MVPDs, *A* and *B*. *As before*, suppose that carriage of the broadcaster's signal over all of the MVPDs in the market (now two, instead of one) generates a total of $6 million in incremental profits, $2 million of which is increased broadcaster advertising revenue and $4 million of which is increased MVPD subscription fees. The incremental profits are seen by comparing the first and last rows of numbers below:

	Broadcaster	**MVPD *A***	**MVPD *B***
No retransmission	**10**	**5**	**5**
Retransmission on *A* only	**11**	**9**	**4**
Retransmission on *B* only	**11**	**4**	**9**
Retransmission on both *A* and *B*	**12**	**7**	**7**

rather, it would opt for must carry and would capture more than half of the total incremental profit. Thus, under the current regulations and assuming that broadcasters have a good sense of their direct and total incremental profits, payments for retransmission will always flow from the MVPD to the broadcaster.

Because there are now two MVPDs, there is also the possibility that the broadcaster reaches a retransmission consent agreement with only one of them. Notice that the broadcaster's profits do not rise quite as much if it reaches agreement with only one MVPD (to $11 million instead of $12 million) because its signal is not as widely distributed. The biggest effect of the broadcaster's reaching agreement with only one MVPD, however, is that the MVPD retransmitting the broadcaster's signal gains significant profits, partly at the expense of the MVPD that does not carry the broadcaster's signal.

25. How will these profits be shared among the broadcaster and two MVPDs? As before, bargaining ability matters. Continue to assume that the parties have equal bargaining ability. There is, however, another factor that now comes into play: the broadcaster may be able to increase its share of the benefits by playing the two MVPDs off against one another. When one MVPD bargains with the broadcaster, the broadcaster and that MVPD will have beliefs about whether the broadcaster and the other MVPD will reach a deal.[34] Suppose MVPD *A* is bargaining with the broadcaster, and both MVPD *A* and the broadcaster expect the broadcaster to reach an agreement with MVPD *B*. If the broadcaster and MVPD *A* do not reach an agreement, then they both expect that: (a) the broadcaster would earn $11 million + R_B, where R_B is the retransmission consent fee paid by MVPD *B*, and (b) MVPD *A* would earn $4 million. If they reach an agreement, they both expect to earn the following profits (ignoring the effects of any retransmission consent fees paid by *A*): (a) the broadcaster would earn $12 million + R_B, and (b) MVPD *A* would earn $7 million. Hence, the incremental

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34 This feature of multilateral bargaining makes the theory of multilateral bargaining difficult. For an analysis of multilateral bargaining in general settings, *see* Adam Brandenburger and Harborne Stuart (2007), "Biform Games," *Management Science*, **53**(4):537-549.

profits over which they are bargaining are \$4 million = (\$12 million + R_B + \$7 million) – (\$11 million + R_B + \$4 million). Assuming, as before, equal bargaining power, the resulting retransmission consent payment will be \$1 million. With this payment, the broadcaster and MVPD *A* each gain \$2 million from their deal. An exactly parallel analysis applies to MVPD *B* and its bargaining with the broadcaster. Thus, the broadcaster collects retransmission consent fees of \$1 million from each of the MVPDs.

26. It is useful to step back and compare the two situations just analyzed. For both the monopoly and duopoly MVPD settings, the total industry gains from retransmission of the broadcaster's signal were assumed to be \$6 million. And in each setting, the parties were all assumed to have equal bargaining skills. However, because of the competition between the MVPDs, the broadcaster was able to double its retransmission consent fees. It is worth reiterating that the retransmission fees doubled even though there was no increase in the benefits created by the broadcaster's signal. All of the change is due to the effects of increased MVPD competition.

27. The effects of MVPD competition can be further understood by considering what would happen if the broadcaster could sign an exclusive retransmission consent agreement with an MVPD. In this case the broadcaster could obtain even higher retransmission consent revenues. Specifically, suppose that the broadcaster announced that it would sign an exclusive agreement with any MVPD willing to pay \$4.9 million. An MVPD that agreed to pay \$4.9 million for the exclusive would earn \$4.1 million = \$9 million – \$4.9 million. If an MVPD did not agree to pay that amount (or offered to pay that amount but was not chosen by the broadcaster), it would earn \$4 million. Hence, each MPVD would rather pay \$4.9 million

for the exclusive than to be left out of the deal. In fact, the broadcaster could get up to $5 million dollars from one of the MVPDs for the exclusive rights to retransmit the broadcaster's signal. If the broadcaster required $5 million for the exclusive, then each MVPD would actually be worse off than if there were no broadcast signal available; each ends up with profits of $4 million rather than $5 million. Thus, the gains to the broadcaster from retransmission ($1 million + $5 million) are larger than the total gains to the industry from retransmission ($4 million). This happens because the exclusive arrangement so effectively allows the broadcaster to play one MVPD competitor off against the other.

28. The logic of the examples above applies to situations in which a significant number of subscribers can and do move among MVPDs to obtain a local broadcast station (*e.g.,* to have access to ABC, CBS, FOX, or NBC), even if some or many do not. The fundamental point here is that the relative bargaining power of the station owner increases significantly when there are multiple MVPDs that can be played off against each another. The station owner's disagreement profits in its negotiation with *A* are higher because some of *A*'s subscribers will shift to *B*, raising the value of the broadcaster's agreement with *B*. Thus, the potential gains from reaching an agreement with *A* are smaller. Hence, economic theory suggests that each station owner will obtain a larger share of incremental gains from an agreement as the number of MVPDs increases.

29. In summary, as competition among MVPDs increases in a specific geographic market and consumers are increasingly able to switch among MVPDs, the relative bargaining position shifts more and more in the favor of the broadcast station owner. Consequently, the split of the incremental profits from retransmission shifts more and more in the favor of the station owner.

IV. BROADCASTERS' BARGAINING POWER HAS SIGNIFICANTLY INCREASED SINCE THE RETRANSMISSION CONSENT REGIME WAS PUT IN PLACE

30. As discussed in the preceding section, the outcome of a retransmission consent negotiation is driven by the relative bargaining positions of the broadcaster and MVPD. These bargaining positions are, in turn, powerfully affected by market conditions. The market today is fundamentally different from what it was when the retransmission consent rules were first adopted. In 1992, the Congress wanted to protect local broadcasters and consumers from the "undue market power" of cable systems that did not face local competition.[35] Today, in local markets across America, cable operators, satellite service providers, and telephone companies compete to provide MVPD services. Indeed, the DC Circuit Court recently found that cable operators face "ever increasing competition," particularly in recent years, from DBS operators and phone companies that "have entered the market and grown in market share since the Congress passed the 1992 Act."[36] Although in 1992 the Congress recognized the possibility of other MVPDs, there is no indication that it anticipated today's marketplace with two or three additional viable MVPD competitors to the established cable operator in almost all markets.[37] This increased competition among MVPDs allows broadcasters to extract higher retransmission fees and other compensation from MVPDs which, in turn, harms consumers.

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35 *Senate Report* at 2**.**

36 Comcast v. FCC, No. 08-1114 (D.C. Cir. Aug. 28, 2009), slip op. at 14.

37 The Senate opined in 1992 that banning exclusive franchises "is not [alone] going to result in overnight competition" (*Senate Report* at 14); that "It would be unreasonable for the Committee to assume that MMDS will provide the necessary nationwide competition to cable" (*Senate Report* at 15); and that prospects for competition from DBS presents "too many unknowns" (*Senate Report* at 17).

31. In 1992, there was typically one cable provider in each local area, and 96 percent of MVPD subscribers received service from a cable company.[38] Hence, a broadcaster typically faced a single cable operator as the sole potential MVPD for the broadcaster's programming. Similarly, because of public policies and network-affiliate agreements, the cable operator could not obtain from any other source the programming broadcast by the local station. Both parties faced significant pressure to reach an agreement because their profits would be lower in the absence of an agreement.

32. Retransmission consent negotiations today take place in a very different economic environment than in 1992: the monopoly positions of cable operators are long gone. Today, cable operators face competition from two nationwide direct broadcast satellite networks. Initially, DBS operators had neither the capacity nor the technology necessary to retransmit local broadcast signals. However, the introduction of spot beam satellite technology—which allows spectrum to be reused multiple times across the country—enabled DBS operators to retransmit hundreds of local signals to local markets across the country.[39] DISH Network, DIRECTV, or both now offer local-into-local service that is accessible by 98 percent of U.S.

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[38] Second Annual Report, *In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, FCC 95-491, rel. December 11, 1995, (hereinafter, "2nd MVPD Competition Report"), Appendix G, Table 1: Assessment Of Competing Technologies. Cable overbuilding was very limited (*2nd MVPD Competition Report* at 16); no LECs had entered into the video services (*2nd MVPD Competition Report* at 50); DBS had almost no subscribers and Home Satellite Dishes had less than two percent of subscribers *(2nd MVPD Competition Report*, Appendix G, Table 1: Assessment Of Competing Technologies).

[39] DBS operators provide local signals in roughly 175 of 210 markets. *(In the Matter of Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming*, Thirteenth Annual Report, FCC 07-206, rel. January 16, 2009 (hereinafter, "Thirteenth MVPD Competition Report"), ¶ 84 .)

households.[40] DBS providers accounted for 32 percent of all MVPD subscribers as of June 2009.[41]

33. In addition, telephone companies have begun to provide multichannel video programming service in numerous markets across the country. The U.S. Department of Justice recently noted that "[t]he most significant development in regard to [multichannel video programming distribution] in the past three years is entry by the principal local telephone companies…. Where incumbent local exchange carriers ('ILECs') have entered, they have often achieved considerable success…."[42] By January 2008, Verizon had already obtained a 17 percent market share for its FiOS video service in the markets it provides video service.[43] In the areas where Verizon has been marketing its video service the longest, its penetration rate (the percentage of customers that have the option to purchase a service who actually purchase the service) is as high as 30 percent.[44]

34. As a result of entry by DBS and telephone companies, cable systems that previously faced little competition in the provision of MVPD services today compete against DBS providers and, in some areas, cable overbuilders, telephone companies, and other emerging technologies. In most local areas, consumers have access to at least three providers--the

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40 *Thirteenth MVPD Competition Report*, ¶ 84.

41 SNL Kagan, *Broadband Technology,* August 24, 2009, at 4.

42 U.S. Department of Justice, "Voice, Video And Broadband: The Changing Competitive Landscape And Its Impact On Consumers," November 2008, at 6, *available at* http://www.usdoj.gov/atr/public/reports/239284.pdf, *site visited* November 6, 2009.

43 Verizon, "Supplement to Verizon Symposium Comments," *available at* http://www.usdoj.gov/atr/public/workshops/telecom2007/submissions/230502.htm, *site visited* November 6, 2009.

44 *Id.*

traditional cable company and two DBS operators, DISH Network, and DIRECTV—and in many DMAs, consumers also have access to phone companies offering video services.[45] As the FCC recently concluded:

> We find that almost all consumers are able to obtain programming through over-the-air broadcast television, a cable service, and at least two DBS providers. In some areas, consumers also may have access to video programming delivered by emerging technologies, such as digital broadcast spectrum, fiber-to-the-home facilities, or web-based Internet video. In addition, through the use of advanced set-top boxes and digital video recorders, and the introduction of new mobile video services, consumers are now able to exercise more control over what, when, and how they receive information.[46]

35. As the following table shows, today only six of the ten largest MVPDs (as measured by subscribers) are traditional cable companies:[47]

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45 DISH Network, DIRECTV, or both offer local-into-local service that is accessible by 98 percent of U.S. households. (*Thirteenth MVPD Competition Report*, ¶ 84.)

46 *Id.*, ¶ 4.

47 Comcast, Time Warner Cable, Cox Communications, Charter Communications, Cablevision Systems, and Bright House Networks are traditional cable operators. DIRECTV and DISH Network are DBS providers. Verizon FiOS and AT&T U-Verse are telephone companies.

Table 1: Largest Multichannel Video Programming Distributors as of June 30, 2009

	Video Subscribers (MM)
Comcast	23.9
DirecTV	18.3
DISH	13.6
Time Warner Cable	13.0
Cox Communications	5.3
Charter Communications	4.9
Cablevision Systems	3.1
Verizon FiOS	2.5
Bright House Networks	2.3
AT&T U-Verse	1.6

Sources: DIRECTV Group, Inc., "The DIRECTV Group Announces Second Quarter 2009 Results," August 6, 2009, *available at* http://investor.directv.com/releasedetail.cfm?ReleaseID=401689, *site visited* October 30, 2009; DISH Network, "DISH Network Reports Second Quarter 2009 Financial Results," August 10, 2009, *available at* http://dish.client.shareholder.com/releasedetail.cfm?ReleaseID=40221, *site visited* October 30, 2009; Verizon, "Verizon Reports Revenue Growth and Continued Improvement in Cash Flow in 2Q," July 27, 2009, *available at* http://newscenter.verizon.com/press-releases/verizon/2009/verizon-reports-revenue.html, *site visited* October 30, 2009; AT&T, "Strong Wireless Growth, Continued Cost Discipline, Solid Free Cash Flow Highlight AT&T's Second-Quarter Results," July 23, 2009, *available at* http://www.att.com/gen/press-room?pid=4800&cdvn=news&newsarticleid=26961, *site visited* October 30, 2009; SNL Kagan, *Cable TV Investor: Deals & Finance*, September 30, 2009.

36. As competition among MVPDs has intensified, the relative bargaining strength of MVPDs in negotiations with local broadcast stations has been weakened. Now, an MVPD faces the prospect of losing more subscribers than it previously would have if it is unable to carry local stations. This is so because a subscriber who cannot get a local broadcast station from his MVPD can now go to a different MVPD to receive that signal, as well as other programming. In contrast, the bargaining position of broadcasters vis-à-vis MVPDs has been

strengthened as a result of these developments.[48] The presence of multiple viable MVPDs in a market means, for example, that if a broadcaster cannot come to an agreement with a cable provider, it can now make agreements with DBS providers and thereby still obtain distribution to a large number of viewers.

37. To the extent that retransmission consent agreements contain most-favored nation (MFN) clauses, the MVPD most eager to reach retransmission consent agreements in a market may establish a precedent that affects the outcome of the broadcaster's negotiations with other MVPDs. This is so because, in the presence of an MFN clause, a high fee to one MVPD would have to be reduced if the broadcaster agreed to charge a lower fee to a second MVPD in the same market. When considering whether to strike a deal with the second MVPD at a lower fee, the broadcaster would take into account the effect of such a deal on fees from the first MVPD and it would thus be more costly to reach an agreement at a lower fee with the second MVPD.[49] The MFN clause would thus serve as a form of commitment

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48 In a recent study sponsored by the National Association of Broadcasters, Jeffrey Eisenach argues that the market for broadcasters has grown less concentrated and the MVPD market has become more concentrated on a national basis. (Jeffrey Eisenach, "The Economics of Retransmission Consent," Empiris, LLC, Sponsored by National Association of Broadcasters, March 2009 (hereinafter, "Eisenach") at 1.) Dr. Eisenach suggests that such evidence means that the regulatory system put in place in 1992 for retransmission consent is still appropriate. However, Dr. Eisenach incorrectly examines the *national* marketplace when retransmission consent negotiations occur for *local* programming. Thus, local market shares are the most appropriate metrics to examine, and as shown in this paper, consumers still value local broadcast stations and local MVPD markets have become significantly more competitive since 1992.

Dr. Eisenach also (incorrectly) claims that increased "clustering" (*i.e.*, one cable company owning multiple systems in the same geographic area) somehow affects the balance of power in negotiations. But Dr. Eisenach's claim is misguided: the increase in clustering does not shift the balance of negotiating power; increased clustering just increases the stakes for *both* the broadcaster and the distributor.

49 A hypothetical example usefully illustrates the logic. Suppose that a broadcaster reaches an agreement with an MVPD having 2,000 subscribers under which the MVPD agrees to pay the

by the broadcaster to hold out for high retransmission consent fees. Consequently, the first MVPD's contract can—if MFNs are in effect—act as a floor for future contracts.

38. Moreover, local broadcasters retain their historic position as the exclusive providers of uniquely attractive network and syndicated programs in their local markets. Although broadcast stations most certainly face increased competition for advertising dollars from other cable programming channels, such an increase in competition for advertising dollars does not necessarily reduce their negotiating power. Indeed, there is no evidence to suggest that the increase in competition for advertising dollars has changed the fact that the broadcasters continue to have the type of mass appeal programming that the FCC has held is sufficiently compelling to cause consumers to switch MVPDs if the content is unavailable on their MVPD. Specifically, the FCC and others have found that when one MVPD does not offer a broadcast station, a significant number of viewers will switch to rival MVPDs to obtain access to that station's unique content.[50] Thus, although there are many more programming channels

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broadcaster $1.00 per subscriber per month. Moreover, suppose that the agreement contains an MFN clause. As long as that clause is not invoked, the broadcaster will receive $2,000 per month under this agreement. Now suppose the broadcaster is considering whether to sign a retransmission agreement with a second MVPD, which has 1,000 subscribers. If the broadcaster accepts less than $1.00 per subscriber from the second MVPD, the payments collected by the broadcaster under the *first* retransmission agreement fall. For instance, suppose that the second MVPD offers the broadcaster a payment of $0.60 per subscriber per month. If the broadcaster accepted this offer, it would receive $600 per month from the second MVPD but the payments from the first MVPD would fall from $2,000 to $1,200 per month due to the MFN clause. Thus, the broadcaster would refuse the deal even if that meant going dark on the second MVPD's system because the combined payments from the first and second MVPDs would be $1,800 per month, as compared to the payment of $2,000 per month from the first MVPD alone.

[50] In its consideration of the merger of DIRECTV and News Corp., the FCC concluded that a temporary withdrawal of a local broadcast signal would "cause a significant number of customers to shift from their current MVPD, which is subject to the foreclosure, to DirecTV." (*News Corp Order*, ¶ 87) An analysis by economists Dan Rubinfeld and Duncan Cameron found that a significant number of Time Warner subscribers switched from Time Warner to

today than in the early 1990s, the FCC concluded that "the signals of local television broadcast stations are without close substitutes."[51]

39. The lack of close substitutes raises an important issue of policy enforcement when broadcasters enter into Local Marketing Agreements (LMAs) or any other form of agreement under which stations in the same DMA jointly negotiate for retransmission consent compensation.[52] To the extent that broadcast stations entering into LMAs are substitutes from the perspective of MVPDs, such joint negotiations eliminate competition and raise the stations' bargaining power, which will result in higher fees and consumer harm.[53]

DIRECTV when Time Warner lost access to ABC in Houston. (*News Corp Order* at Appendix D, fn. 49.) Similarly, the FCC analysis found a "statistically significant increase in the growth rate of DirecTV in the ZIP codes where consumers were continually being told that they were likely to be losing access to the ABC affiliate on the incumbent cable operator." (*News Corp Order* at Appendix D, ¶ 21.) One of the co-authors of this paper and Princeton University economics professor Robert Willig found "robust empirical evidence that when EchoStar offered local-into-local service in a DMA *without* one of the four major networks (ABC, NBC, CBS, or Fox), the omission significantly reduced the subscriber acquisition rate and the market share gains from offering local programming." (Letter from Pantelis Michalopoulos, Steptoe and Johnson, L.L.P., to Marlene H. Dortch, Secretary, MB Docket No. 03-124, December 15, 2003, at 6, emphasis in original.) Professor Willig in a litigation matter stated, "not offering CBS harms EchoStar's market penetration rate because it *both* significantly reduces EchoStar's ability to obtain new subscribers and to keep existing subscribers." (Declaration of Robert D. Willig, *in re*: EchoStar Satellite L.L.C. v. Viacom Inc., *et al.*, ¶ 28, emphasis in original.)

51 *News Corp Order*, ¶ 202.

52 Mediacom recently filed a complaint with the FCC alleging that Sinclair Broadcast Group entered into LMAs with local competitors in order to fix and elevate the price of retransmission consent. (*Mediacom Communications Corporation v. Sinclair Broadcast Group*, October 22, 2009.)

53 For an antitrust analysis of how the loss of competition among broadcasters could result in higher retransmission consent fees, *see,* Competitive Impact Statement, *U.S. v. Texas Television, Inc., Gulf Coast Broadcasting Company, and K-Six Television, Inc.,* Civil No. C-96-64 (S.D. Texas, 1996), *available at* http://www.justice.gov/atr/cases/f0700/0746.htm, *site visited* November 2, 2009.

40. It is also worth recalling that the public policies and private contracts discussed in Section II.B above that prevent an MVPD from obtaining access to network programming from outside of the local market for which retransmission consent is being negotiated remain in effect. The result is to eliminate any competition among affiliates of a given broadcast television network—entities whose signals might otherwise serve as partial substitutes for one another—when negotiating with MVPDs regarding retransmission rights.

41. The nature of MVPD competition gives rise to another factor that affects the relative bargaining strength of broadcasters and MVPDs: the adverse consequences of failing to reach a retransmission consent agreement may persist longer for an MVPD than for a broadcast station. The logic is the following. If an MVPD and a broadcaster fail to reach an agreement, some subscribers will switch MVPDs in order to continue receiving the broadcast station's signal. Subscribers who have switched MVPDs to obtain the broadcast station will not automatically switch back to their original MVPD if or when an agreement is reached. On the other hand, if the broadcast station loses viewers during the period when there is no agreement, those viewers can easily resume viewing the broadcaster's signal once an agreement is reached.

42. Although the FCC and the Congress's regulatory policies have encouraged the entry of new MVPD competitors, thereby weakening the bargaining position of the MVPDs in retransmission consent negotiations, there has been no concomitant attempt to give MVPDs new tools in these negotiations to prevent, or at least limit, the extent of this weakening. For example, MVPDs are still prevented by rule and by contract from entering into carriage arrangements with distant network broadcast affiliates (those outside the market served by the MVPD) in the event that an agreement with the local-market affiliate is not renewed.

Moreover, to the extent that MVPDs believe politicians will disproportionately blame the MVPD for the loss of a broadcast signal when a retransmission consent negotiation breaks down, those perceived political pressures will weaken MVPDs' bargaining position further.[54]

43. In summary, changes in the nature of competition in the MVPD marketplace have asymmetrically strengthened the bargaining position of the broadcasters relative to the MVPDs in a way unanticipated by the original retransmission consent rules.[55] Because of this shift in power, bargaining theory would predict a shift in the terms of agreements to favor the broadcast stations, and this has detrimental effects on consumers as described in the next section.

V. CONSUMER HARM FROM THE CURRENT RETRANSMISSION CONSENT REGIME

44. In this section, we examine the consumer welfare consequences of maintaining the current retransmission consent regime in a marketplace in which broadcasters have increased bargaining power. Although consumers are not a party to retransmission negotiations, they are nonetheless affected by the outcomes of those negotiations. When negotiations are prolonged or unsuccessful, consumers can lose access to broadcast programming. Even when negotiations are successful and the parties reach an agreement, consumers are harmed when retransmission consent fees raise MVPDs' costs and induce them to charge higher subscription fees to consumers. These costs are unavoidable for MVPD customers; cable

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54 A potential basis for such concerns on the part of MVPDs is that broadcasters have often received favorable public policy treatment, such as the grant of free spectrum licenses and the public subsidies of the transition to digital broadcasting.

55 Broadcasters also enjoy the regulatory asymmetry of being able to choose between the options of must carry and retransmission consent.

customers are required by law to purchase access to broadcast signals, and satellite providers generally package their offerings in the same way. Thus, increases in the bargaining strength of broadcasters relative to MVPDs can harm consumers.

A. HIGHER PRICES

45. Retransmission consent fees harm consumers when those fees result in higher prices for MVPD services. The extent to which consumers face increased prices depends on how much MVPDs pay for retransmission rights and the degree to which MVPDs pass these costs on to consumers in the form of higher monthly subscription fees. As we will now show, retransmission fees are large and growing, and a significant percentage of these costs are passed on to consumers.

46. Most initial retransmission consent agreements between cable operators and broadcasters did not involve cash compensation to broadcasters. Rather, local broadcasters negotiated for and received carriage on cable of additional affiliated channels. This in-kind compensation resulted in the cable operators' agreeing to carry programming owned by the television networks with which the local station was affiliated.[56]

47. In recent years, broadcasters have made no secret of their desire to gain cash retransmission fees. In the last retransmission consent election cycle, several broadcasters

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[56] In some circumstances, in-kind compensation could distort MVPDs' programming decisions to the detriment of consumers. Our analysis below focuses on the consumer-welfare effects of cash compensation, which has become increasingly significant in recent years and is expected to continue growing in coming years.

publicly announced their intention to make retransmission cash a primary source of revenue.[57] The increased demands for cash compensation are likely due to a variety of additional factors, including broadcasters' desires to replace declining advertising revenues; diminishing returns from the creation of new cable programming networks; and the fact that some broadcast station groups have been purchased by private equity firms, resulting in needs for cash to service debt obligations.[58]

48. Of course, seeking increased cash payments and obtaining them in a negotiation are two different things. But given the shift of bargaining power over time in favor of broadcasters relative to MVPDs, one would expect broadcasters to succeed in obtaining increased cash payments, and retransmission consent payments have, in fact, risen dramatically.[59,60] As shown in Table 2, industry analyst SNL Kagan estimates that retransmission fees have increased significantly in each of the past several years and predicts

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57 *See, e.g.*, Mike Farrell, "Moonves: Time Warner Retransmission-Consent Deal a 'Template'," *Multichannel News*, January 6, 2009; David Goetzl, "Time Warner: Pay Univision Retrans Fees Or Face Consequences," *MediaNewsDaily*, July 28, 2008.

58 *See, e.g.*, Robert Marich, "Private Equity: Buying In To Cash Out," *Broadcasting & Cable*, August 25, 2008, *available at* http://www.allbusiness.com/entertainment-arts/broadcasting-industry-television/11666502-1.html, *site visited* September 4, 2009.

59 In his paper, Dr. Eisenach implies that consumers are somehow not harmed by retransmission consent payments because "monetary compensation represents a tiny fraction of cable operators' revenues." (*Eisenach* at 31.) The issue, however, is not whether retransmission consent fees are a significant *share* of the revenues collected by firms that provide cable services (particularly given that those revenues increasingly include amounts derived from telephone and high-speed Internet services), but whether the *dollar amount of retransmission consent fees* has a significant effect on consumer demand and consumer welfare. Similarly, size comparisons between projected increases in retransmission consent fees and cable operator revenues are largely irrelevant to the analysis of consumer welfare.

60 Broadcasters seek (and receive) both cash and non-cash compensation. In theory, there could be conditions under which an increase in broadcaster bargaining power leads to a decrease or no effect on cash compensation as broadcasters seek greatly increased non-cash compensation. In practice, one would expect broadcasters to exercise their increased bargaining power to obtain more of both types of compensation.

that these fees will continue to increase substantially for the foreseeable future.[61] These increases appear to reflect some combination of: (a) broadcast stations' changing their election from must carry to retransmission consent and successfully negotiating cash agreements, and (b) broadcast stations' negotiating with MVPDs for cash retransmission fees in addition to in-kind compensation granted under previous retransmission consent agreements.[62]

Table 2: Estimated Cash Retransmission Fees
2006-2015 est., by MVPD Type

	Estimated Cash Retransmission Fees ($MM)			
	Cable	**DBS**	**Telco**	**Total**
2006	$44.3	$168.7	$1.6	$214.6
2007	$86.0	$216.6	$10.9	$313.5
2008	$188.9	$277.7	$33.5	$500.1
2009	$315.2	$352.1	$71.4	$738.7
2010	$424.0	$390.0	$119.1	$933.1
2011	$573.8	$425.9	$161.3	$1,161.0
2012	$639.6	$451.3	$192.6	$1,283.5
2013	$709.4	$467.7	$220.3	$1,397.4
2014	$835.8	$484.7	$245.0	$1,565.5
2015	$861.9	$500.7	$267.4	$1,630.0

Source: SNL Kagan, "Broadcast retrans fees on track to break $1 bil. by 2011," *Broadcast Investor: Deals & Finance*, June 30, 2009.

61 SNL Kagan, "Broadcast retrans fees on track to break $1 bil. by 2011," *Broadcast Investor: Deals & Finance,* June 30, 2009. *See also, e.g.*, Mike Farrell, "Retransmission-Consent Fees Boost Broadcast Revenue: Kagan Study," *Multichannel News*, January 3, 2009, *available at* http://www.multichannel.com/article/161507-Retransmission_Consent_Fees_Boost_Broadcast_Revenue_Kagan_Study.php, *site visited* March 28, 2009; Linda Moss, "Nexstar Pulls In $40M from Retrans Deals," Multichannel News, January 19, 2006, *available at* http://www.multichannel.com/article/121829-Nexstar_Pulls_In_40M_from_Retrans_Deals.php, *site visited* March 28, 2009.

62 SNL Kagan, "Broadcast retrans fees on track to break $1 bil. by 2011," *Broadcast Investor: Deals & Finance,* June 30, 2009.

49. The differing experiences of cable, DBS, and telephone company MVPDs in retransmission negotiations are instructive. Consider first the experience of cable operators. In the first decade of the retransmission consent regime, broadcast networks negotiating retransmission consent agreements with cable operators on behalf of their owned and operated television stations allowed retransmission of their broadcasts in exchange for carriage of one or more affiliated programming services (such as MSNBC or ESPN Classic). Cable operators did not face much, if any, competition in the provision of MVPD services in their local markets and were able to deflect cash demands by providing valuable in-kind compensation. The retransmission agreements that were reached in this time period gave cable operators access to broadcast programming and new channels, and gave broadcasters distribution not only for their broadcast programming (thus preserving or expanding their advertising revenues) but also for their new cable-only networks. More recently, coinciding with the market entry of DBS operators and then phone company video providers, broadcasters have sought and won cash compensation in addition to carriage of broadcaster-affiliated programming in exchange for retransmission consent. As competition faced by cable operators in the MVPD market has increased, the demands of broadcasters have increased and the ability of cable operators to resist them has decreased. Thus, as shown in Table 2, total cash fees paid by cable operators have increased and, as shown in Table 3, the number and share of cable subscribers that are subject to the fees have grown and are projected to continue growing substantially in future.

Table 3: Subscribers and Stations under Cash Retransmission Deals 2006-2015 (est.), by MVPD Type

	Estimated MVPD Subscribers Subject to Cash Retransmission Fees (MM)				Estimated Share of Subscribers Subject to Cash Retransmission Fees				Estimated Average Number of Stations in each Market Subject to Cash Retransmission Fees (MM)		
	Cable	DBS	Telco	Total	Cable	DBS	Telco	Total	Cable	DBS	Telco
2006	11.7	28.1	0.1	39.9	18%	97%	33%	42%	1.5	2.5	3.0
2007	16.3	29.8	0.7	46.8	25%	97%	54%	48%	2.0	2.8	3.5
2008	32.1	31.0	2.0	65.1	50%	99%	65%	66%	2.1	3.3	3.7
2009	47.6	31.5	4.1	83.2	75%	99%	72%	83%	2.3	3.8	3.8
2010	56.5	32.0	6.5	95.0	91%	99%	80%	93%	2.5	3.9	3.9
2011	59.0	32.4	8.4	99.8	95%	99%	87%	96%	3.0	4.0	4.0
2012	58.6	32.7	9.9	101.2	95%	100%	89%	96%	3.3	4.0	4.0
2013	58.2	32.9	11.1	102.2	95%	100%	91%	96%	3.5	4.0	4.0
2014	58.0	33.1	12.1	103.2	95%	100%	92%	96%	4.0	4.0	4.0
2015	57.9	33.2	12.9	104.0	95%	100%	92%	96%	4.0	4.0	4.0

Source: SNL Kagan, "Broadcast retrans fees on track to break $1 bil. by 2011," *Broadcast Investor: Deals & Finance*, June 30, 2009.

50. DBS providers entered the MVPD marketplace after cable operators were already well established. Industry analyst SNL Kagan estimates that, on average, retransmission deals with DBS providers and retransmission deals with cable operators yield approximately the same payment *per subscriber per broadcast signal when cash compensation is involved*. However, these approximately equal payment amounts are applied to very different bases. Specifically, there are two differences: (a) DBS providers, on average, sign cash compensation deals for more channels in any given local market than do cable operators, and (b) cash compensation deals cover a much larger percentage of DBS subscribers than cable subscribers (see Table 3). As a consequence of (a) and (b), DBS providers, on average, pay more *per subscriber* than do cable operators. (See Table 4.) Although it is difficult to ascertain precisely why these differences between cable and DBS payments exist, they most likely reflect the timing of DBS' entry. For example, unlike cable operators, when DBS providers entered local markets with local broadcast stations, they often faced competition from each other and almost always faced competition from a local cable operator.

Table 4: Estimated Average Cash Retransmission Fees
2006-2015 (est.), by MVPD Type

	Estimated Cash Retransmission Fees ($MM)				Estimated MVPD Subscribers Subject to Cash Retransmission Fees (MM)				Estimated Per-Sub, Per-Month Cash Retransmission Fees			
	Cable	DBS	Telco	Total	Cable	DBS	Telco	Total	Cable	DBS	Telco	Average
2006	$44.3	$168.7	$1.6	$214.6	11.7	28.1	0.1	39.9	$0.32	$0.50	$1.33	$0.45
2007	$86.0	$216.6	$10.9	$313.5	16.3	29.8	0.7	46.8	$0.44	$0.61	$1.30	$0.56
2008	$188.9	$277.7	$33.5	$500.1	32.1	31.0	2.0	65.1	$0.49	$0.75	$1.40	$0.64
2009	$315.2	$352.1	$71.4	$738.7	47.6	31.5	4.1	83.2	$0.55	$0.93	$1.45	$0.74
2010	$424.0	$390.0	$119.1	$933.1	56.5	32.0	6.5	95.0	$0.63	$1.02	$1.53	$0.82
2011	$573.8	$425.9	$161.3	$1,161.0	59.0	32.4	8.4	99.8	$0.81	$1.10	$1.60	$0.97
2012	$639.6	$451.3	$192.6	$1,283.5	58.6	32.7	9.9	101.2	$0.91	$1.15	$1.62	$1.06
2013	$709.4	$467.7	$220.3	$1,397.4	58.2	32.9	11.1	102.2	$1.02	$1.18	$1.65	$1.14
2014	$835.8	$484.7	$245.0	$1,565.5	58.0	33.1	12.1	103.2	$1.20	$1.22	$1.69	$1.26
2015	$861.9	$500.7	$267.4	$1,630.0	57.9	33.2	12.9	104.0	$1.24	$1.26	$1.73	$1.31

Note: Per-sub, per-month fee is average over MVPD subscribers who are subject to retransmission fees.
Source: SNL Kagan, "Broadcast retrans fees on track to break $1 bil. by 2011," *Broadcast Investor: Deals & Finance*, June 30, 2009.

51. Recent telephone company entrants to the MVPD marketplace face competition from both cable operators and DBS providers. Telephone company video providers are estimated to pay significantly more per subscriber than cable and satellite operators in the retransmission deals that they have struck. SNL Kagan estimates that telephone company providers paid 50 percent more per subscriber per month in 2009 than did cable and DBS.[63] (See Table 4.) In total, retransmission fees paid by DBS and telephone companies are expected to continue to grow significantly. (See Table 4.)

52. The ability of broadcasters to extract large and growing cash payments drives up MVPDs' costs of providing service to their household customers. Economically rational MVPDs raise subscription charges in response to increased marginal costs.[64,65] In an analysis

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63 SNL Kagan, "Broadcast retrans fees on track to break $1 bil. by 2011," *Broadcast Investor: Deals & Finance*, June 30, 2009. *See also* Table 4.

64 This conclusion holds for both polar cases of competition; that is, both a profit-maximizing monopolist and a profit-maximizing perfectly competitive firm will pass through industry-wide cost increases. *See*, for example, Michael L. Katz and Harvey S. Rosen, *Microeconomics*, 3rd edition, 1998, Boston, Mass: Irwin McGraw-Hill, at 349-354 and 421-23.

of retransmission consent, former FCC Chief Economist William Rogerson noted that because retransmission fees are typically negotiated on a per-subscriber basis, they are a marginal cost and therefore would be at least in part passed through to consumers.[66] Indeed, the FCC concluded that higher retransmission consent prices "ultimately are passed on to consumers."[67]

53. The conclusion that increased retransmission consent fees are passed through to consumers is also supported by a study of cable prices by Ford and Jackson (1997) showing that, in general, changes in programming costs are passed through to MVPD subscribers at a rate of about 50 percent.[68, 69]

54. The increased subscription fees due to retransmission consent fees represent a loss of consumer welfare. In 2009, cash retransmission consent fees are estimated to total $739 million. Those fees are distributed unevenly among different markets, however, and not all consumers subscribe to an MVPD that pays retransmission fees. As shown in Table 4, SNL Kagan estimates that 83.2 million households were subscribers to MVPDs that paid cash

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[65] Under the FCC's rate regulation rules, retransmission consent fees are considered "external costs" that can be passed through. *See* 47 C.F.R. § 76.922(f)(1)(iv) (defining retransmission consent fees as an external cost); id. § 76.922(d)(3), (e)(2)(ii) (treatment of external costs).

[66] William Rogerson, "The Social Cost of Retransmission Consent Regulations," Appendix to *Comments of Joint Cable Commenters*, February 25, 2005, *In the Matter of Rules Affecting Competition in the Television Marketplace*, MB Docket 05-28, at 50-51.

[67] *News Corp Order*, ¶ 204.

[68] George S. Ford and John D. Jackson (1997), "Horizontal Concentration and Vertical Integration in the Cable Television Industry," *Review of Industrial Organization*, **12**(4):501-518 at 513-14.

[69] The FCC found that approximately 60 to 66 percent of increased subscription fees between July 2000 and July 2002 were due to programming cost increases. (Federal Communications Commission, *Report on Cable Industry Prices*, MM Docket No. 92-266 (rel. July 8, 2003), at 13.)

retransmission fees in 2009. The average fee per subscriber is therefore \$0.74 per month, or \$8.88 per year. Even if only 50 percent of these fees are passed on to consumers, consumers are paying an additional \$4.44 per year for the retransmission of signals that the Congress intended for households to be able to receive at no charge from broadcasters that were granted free spectrum licenses.[70] If the pass-through rate is higher, which is possible given the changes in the industry since the studies cited above were conducted, consumers could be paying even more; for example, if the pass-through rate is 75 percent, consumers are paying an additional \$6.66 per year to obtain broadcast stations via their MVPD.[71] Because MVPDs generally provide all broadcast signals to all of their subscribers, whether by law or by practice, this means increased monthly fees for all MVPD subscribers.

55. Retransmission consent fees harm consumers in another way as well: because retransmission consent fees drive up MVPD subscription fees, some consumers are discouraged from subscribing to MVPD services at all. In fact, as we now demonstrate, economic analysis indicates that over a million households likely forgo the benefits of MVPD services because of the higher subscription fees they face as the result of retransmission consent fees. This conclusion follows from taking the estimated increases in subscription fees

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70 The fact that MVPDs pass through increases in marginal costs to consumers reflects the functioning of competition in the market. Despite this fact, some commentators may suggest that an appropriate policy response would be to regulate MVPD rates so that increases in retransmission consent costs are not passed through to MVPD subscribers. From an economic perspective, such a policy response would be deeply flawed and would cause far more significant harms to consumer welfare than the harms associated with increased retransmission consent costs.

71 As observed in footnote 64 above, almost all profit-maximizing suppliers will pass through at least some portion of industry-wide cost increases. A range of different pass-through rates are possible in an industry without perfect competition; in an industry with perfect competition, the pass-through rate will be 100 percent. Ford and Jackson’s estimate of a pass-through rate of 50 percent uses data from a period when MVPD distribution was a less competitive market than it is today, so it is likely that pass-through rates today are higher.

due to retransmission consent costs and then converting the percentage increase in subscription fees into a percentage demand reduction.

56. The relationship between the percentage price increase and the resulting percentage demand reduction is known as the price elasticity of demand. Estimates of the elasticity of demand for MVPD services are in the neighborhood of –1.5.[72] These estimates imply that a 10 percent increase in MVPD subscription fees will lead to a 15 percent reduction in the number of households subscribing to MVPD services.

57. As shown in Table 5, retransmission consent fees at current average levels of about $0.74 per subscriber per month are estimated to have reduced the number of households enjoying the benefits of MVPD services by between 630,000 and 2.3 million.[73]

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[72] Rubinovitz (1993) estimated that the demand elasticity for basic cable was –1.5; this analysis uses data from a time period when MVPDs were nearly all cable systems, so this estimate corresponds to an industry elasticity of the type needed for the calculations here. (Robert N. Rubinovitz (1993), "Market Power and Price Increases for Basic Cable Service since Deregulation," *RAND Journal of Economics,* **24**(1): 1-18 at 13.) Goolsbee and Petrin (2004), using more recent data (2000-2001), estimated that the demand elasticity for expanded basic was –1.53, while for DBS it was –2.45. (Austan Goolsbee and Amil Petrin (2004), "The Consumer Gains from Direct Broadcast Satellites and the Competition with Cable TV," *Econometrica* **72**(2):351-381 at 369.) Because industry elasticities should be lower than the elasticities for individual products in an industry, a demand elasticity of somewhat less than the Goolsbee-Petrin estimates for individual products is appropriate.

[73] The range given here uses total per subscriber fees of $0.74 per month, which is the current average estimated by SNL Kagan; a range of demand elasticities of –1.00 to –1.75; and a range of pass-through rates from 50 to 100 percent. *See* Table 5 for details.

Table 5: Number of Households that Do Not Subscribe to MVPD Service For Different Values of Fees, Passthrough Rates, and Elasticities

		Cash retransmission fees per subscriber per month	
		$0.74	**$1.31**
Passthrough rate	100%		
High elasticity	-1.75	2,262,816	4,142,158
Mid elasticity	-1.5	1,932,050	3,525,348
Low elasticity	-1	1,278,140	2,317,499
Passthrough rate	75%		
High elasticity	-1.75	1,679,171	3,047,023
Mid elasticity	-1.5	1,435,152	2,598,141
Low elasticity	-1	951,298	1,714,250
Passthrough rate	50%		
High elasticity	-1.75	1,107,737	1,993,114
Mid elasticity	-1.5	947,686	1,702,557
Low elasticity	-1	629,401	1,127,348

Notes: The calculations use the average monthly price for expanded basic cable less the passed-through retransmission fees as the base price. The average monthly price for expanded basic was $49.65 in the 12 months ended January 2008. (FCC, *Report on Cable Industry Prices*, DA09-53, rel. January 16, 2009.)

Kagan estimated that 83.2 million households subscribed to MVPDs who paid cash retransmission fees in 2009. (See Table 4.)

58. The consumer harms of the retransmission consent system are projected to grow. As shown in Tables 2-4, cash retransmission fees are projected to rise dramatically between 2009 and 2015. Additional households will forgo MVPD services as these cost increases are passed through to retail prices. Specifically, average fees are projected to increase from $0.74 to $1.31, which would result in an additional 500,000 to 1.9 million subscribers' foregoing MVPD service.[74]

[74] These service loss projections do not include effects on subscribers who are in areas where they are not currently subject to retransmission fees but will be in the future. The service loss projections are calculated as the difference between the number of subscribers who forego MVPD service when retransmission fees are $1.31 per subscriber per month, less the

B. Reduced Output Due To Loss of Service

59. Another way in which the current retransmission consent regime harms consumers is by leading them to lose access to broadcast television signals when retransmission consent negotiations break down. This loss of service occurs when a broadcaster withdraws permission for its signal to be retransmitted and an MVPD is forced to remove the station from its system.[75]

60. As summarized in Table 6, hundreds of thousands of consumers have been affected by these breakdowns. When broadcasters withdraw retransmission rights and a station goes dark on a cable, satellite, or phone company video service, subscribers to that service suffer from lost or degraded access to the station's programming and may have to switch providers to regain it.

61. The FCC itself has recognized the cost to consumers of interruption of broadcast retransmissions over MVPD services. For example, in its consideration of News Corporation's acquisition of a controlling interest in DIRECTV, the FCC found that "loss of access to local broadcast stations signals harm consumers who cannot access desired Fox programming, local news and public affairs programming, and other programming available on the affected stations, even if the loss is temporary."[76]

62. Broadcasters can threaten to withhold their signals at selective times in order to maximize their negotiating leverage, which can result in more serious harm to consumers.

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estimated number who forego MVPD service when retransmission fees are \$0.74 per subscriber per month, at different demand elasticities and pass-through rates. *See* Table 5.

[75] Dr. Eisenach includes a list of programming disruptions in his paper. *See Eisenach* at Table 2. However, his list is incomplete, as evidenced by the table below.

[76] *News Corp Order*, ¶ 210.

When distributors and broadcasters cannot agree on the terms for retransmission consent, broadcasters will typically agree to extend retransmission consent agreements for short periods of time. This gives broadcasters the power to withdraw consent strategically before critical events for viewers, such as the Super Bowl or college basketball's "March Madness." Consumers can thus suffer from losing access to particularly valuable events or content.[77]

VI. CONCLUSION

63. In order to promote the public policy goal of enhancing consumer welfare, the Congress and the FCC have periodically reviewed and revised the rules under which broadcasters' programming content is distributed over MVPD systems. Changes in the MVPD market in recent years have shifted the balance of power in negotiations towards broadcasters. This shift has harmed consumers by triggering higher prices. The retransmission consent system also harms consumers by triggering the intermittent loss of service. The retransmission consent system should be reviewed to determine the consumer benefits of restoring the balance between the parties in retransmission consent negotiations. Commentators have proposed a variety of ideas that should be examined in more depth. These ideas include allowing MVPDs to import broadcast signals from neighboring areas; mandatory arbitration proceedings; and the use of a compulsory copyright royalty.

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[77] For example, news reports indicate that Viacom threatened to withhold CBS from EchoStar just prior to the 2004 Super Bowl (Robert Manor, "Viacom, EchoStar Settle Dispute," *Chicago Tribune,* March 12, 2004) and that Sinclair withdrew consent from Mediacom to rebroadcast its stations just a month before the Super Bowl in 2007. (Ted Hearn and Linda Moss, "Sens. Urge FCC to Settle Sinclair-Mediacom Dispute," *Multichannel News*, January 31, 2007, *available at* http://www.multichannel.com/article/86190-Sens_Urge_FCC_to_Settle_Sinclair_Mediacom_Dispute.php, *site visited* October 30, 2009.)

Table 6: Selected Instances of Service Interruptions Since 2000 as a Result of Failure of Retransmission Consent Negotiations

Date	Stations	Station Owner	Cities	MVPD	Description
January 2000		Fox		Cox Communications	400,000 cable subscribers lost access to Fox channels as a result of Fox and Cox's failure to reach a retransmission consent agreement. Fox had asked Cox to carry FXM and Fox Sports World on all of its digital networks, which Cox resisted because it said the channels were not in demand and it refused to pass costs onto customers.
May 2000		ABC		Time Warner Cable	Following a multi-month dispute over contract renegotiation, 3.5 million viewers lost access to ABC for 39 hours.
2004		Viacom		EchoStar	DISH network subscribers lost access to 15 CBS and 10 affiliated networks for 46-hours; cable-operators aggressively sought to attract DISH subscribers; network-station loss affected approximately 1.6 million subscribers, affiliated-networks loss affected 9.5 million subscribers; as part of the renegotiation, DISH agreed to a carriage of Nicktoons, and both sides agreed to drop litigation, including an antitrust lawsuit accusing Viacom of tying retransmission of the CBS network to CBS-owned cable-networks
January - December 2005	KSNF (NBC), KODE (ABC), KTAL (NBC), KAMR (NBC)	Nexstar Broadcasting*	Joplin, MO; Shreveport, LA; Amarillo, TX	Cable One	75,000 cable subscribers lost access to Nexstar broadcast stations for nearly a year as a result of a dispute over retransmission consent.

Date	Stations	Station Owner	Cities	MVPD	Description
January - October 2005	21 Stations	Nexstar Broadcasting*	13 Markets	Cox Communications	Cable subscribers lost access to Nexstar stations for more than nine months as a result of a dispute over retransmission consent; Nexstar originally sought cash compensation for retransmission; the terms of the ultimate agreement were not disclosed.
July 2006	WCHS-TV (ABC), WVAH-TV (Fox)	Sinclair Broadcast Group	Charleston, West Virginia	Suddenlink Communications	Sinclair demanded a $40M upfront fee and $1 monthly fee per subscriber to allow Suddenlink to retransmit two stations in one local market; Sinclair sent Suddenlink an email stating that carrying the stations beyond the following day would constitute an acceptance of the agreement; the parties reached a deal by late July; the terms of the agreement were not disclosed.
January 2007 - February 2007	23 Stations, including affiliates of Fox, ABC, NBC, CBS, The CW and My Network TV	Sinclair Broadcast Group	12 States	Mediacom	700,000 Mediacom subscribers lost access to 23 Sinclair stations for nearly one month doe to failure to reach agreement on retransmission consent. The parties reached a deal February 2, 2007 which reportedly involves cash compensation, although the terms of the agreement were not publicly disclosed. Mediacom reported that it lost approximately 7,000 customers due to the dispute.
2008	WHBF (CBS), WOI (ABC), KLKN (ABC), KCAU (ABC)	Citadel Communications	Davenport, Iowa; Des Moines, Iowa; Lincoln, Nebraska; Sioux City, Iowa	DISH Network	DISH subscribers lost access to four Citadel stations in four local markets for five weeks after DISH and Citadel failed to renegotiate their retransmission consent agreement. Citadel was seeking a price increase.

Date	Stations	Station Owner	Cities	MVPD	Description
October 2008	15 Stations	LIN TV	15 Markets	Time Warner Cable, Bright House Networks	1.5 million Time-Warner subscribers and 106,000 Bright House customers lost access to 15 stations in 15 local markets for approximately one month after the cable companies and LIN TV failed to reach a retransmission consent agreement. The ultimate agreement reportedly involved cash payments.
December 18, 2008 - Present	9 Stations	Fisher Communications	7 Markets	Dish Network	DISH subscribers lost access to nine stations in seven local markets in the Northwest, including a Univision affiliate in Seattle, when DISH and Fisher Communications were unable to reach a retransmission consent agreement.
December 2008	10 Stations	Young Broadcasting	11 Markets	DISH Network	DISH subscribers lost access to 10 stations in 11 markets for three days until DISH and Young Broadcasting reached a retransmission consent agreement. Young was seeking rate-increases; the terms of the agreement were not disclosed.
January 2009	KMBC (ABC), KCWE (CW)	Hearst-Argyle	Kansas City, MO	Sunflower Broadband	31,000 cable subscribers lost access to two Hearst-Argyle stations after the station owner and cable system failed to reach an agreement to extend their retransmission consent agreement. An agreement under undisclosed terms was reached after one month.
January 2009	KTKA-TV (ABC)	Free State Communications	Topeka, Kansas	DISH Network	DISH Network subscribers lost access to the ABC affiliate, KTKA, for one week after Free State Communications and DISH failed to reach a retransmission consent agreement; the terms of the ultimate agreement were not disclosed.