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

In the Matter of	
REVISION OF THE COMMISSION'S PROGRAM ACCESS RULES	MB Docket No. 12-68
NEWS CORPORATION AND THE DIRECTV GROUP, INC., TRANSFERORS, AND LIBERTY MEDIA CORPORATION, TRANSFEREE, FOR AUTHORITY TO TRANSFER CONTROL	MB Docket No. 07-18
APPLICATIONS FOR CONSENT TO THE ASSIGNMENT AND/OR TRANSFER OF CONTROL OF LICENSES, ADELPHIA COMMUNICATIONS CORPORATION (AND SUBSIDIARIES, DEBTORS-IN-POSSESSION), ASSIGNORS, TO TIME WARNER CABLE, INC. (SUBSIDIARIES), ASSIGNEES, ET AL.	MB Docket No. 05-192

COMMENTS OF DIRECTV, LLC

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SUMMARY

Five years ago, the Commission extended the ban on exclusive carriage arrangements between cable operators and cable-affiliated programmers based on the finding that, in the absence of an extension, competition and diversity in the distribution of video programming would not be preserved and protected. Much has changed in the last five years. Yet the concerns that justified extension in 2007 nonetheless remain valid today.

In determining whether to extend the prohibition, the Commission considers not only specific factual evidence of exclusionary conduct, but also economic theory and the application of its own predictive judgment. All three argue strongly for extension.

Factual Evidence. Cable-affiliated programmers continue to own some of the most highly rated and broadly distributed video programming networks, without which any MVPD would be at a serious competitive disadvantage. Because the cable exclusivity prohibition has been in force since 1992, there is little direct evidence of how cable-affiliated programmers would behave in its absence. However, the Commission has repeatedly confirmed over the last few years that cable operators continue to have the incentive and ability to withhold affiliated programming from competitors, to the detriment of competition and consumers. More generally, although cable's dominant *national* market share is diminishing, several factors point to an increased incentive and ability to act anticompetitively, including cable's continuing outsized *regional* market share. In addition, because of the increasing importance of bundling video with broadband and voice services, cable's market share in the majority of the country where

it does not face a wireline competitor is stabilizing, and may start to increase in the near future.

Economic Theory. As shown in the attached report submitted by Professor Kevin Murphy, economic theory also supports retention of the exclusivity ban. Practices that are widely used in contexts where market power is not a concern are generally presumed to be efficient. As he points out, however, national networks and RSNs that are not affiliated with cable (and therefore are not subject to the prohibition) rarely enter into exclusive carriage agreements. This is not surprising given the characteristics of the MVPD industry, but it undermines cable operators' assertions that programming exclusivity is efficient and procompetitive. Indeed, because vertical integration can achieve the alignment of incentives that underlies efficient exclusivity, cable-affiliated programmers should be *less* likely to withhold than are non-integrated programmers. Yet in practically every instance where a cable-affiliated RSN was not subject to the prohibition (because of terrestrial delivery), the programmer engaged in some form of withholding. The contrast could not be more stark, and clearly demonstrates that exclusivity in those cases resulted from something other than an efficiency-based motivation.

Extending the bargaining analysis he developed (and the Commission adopted) in the Comcast/NBCU proceeding and applying it to the available empirical evidence, Professor Murphy demonstrates that cable-affiliated programmers would be most likely to withhold where offering the programming on a non-exclusive basis would result in the best pricing outcomes for consumers—in other words, *precisely when withholding is most likely to do the most harm*. He concludes that there would be little (if any) loss of efficiency from extending the cable exclusivity prohibition, but doing so could provide competing MVPDs access to programming consumers value in precisely those cases that would have the largest benefits for consumers and competition.

Predictive Judgment. A straightforward application of the Commission's predictive judgment to these facts and the associated economic theory leads to one conclusion: in the absence of the cable exclusivity prohibition, cable-affiliated programmers will engage in exclusionary conduct that is not procompetitive, to the detriment of consumers. Accordingly, extension of that prohibition is necessary to preserve and protect competition and diversity in the distribution of video programming.

That DIRECTV supports this conclusion is telling, because it is not only a competitor to cable, but also is subject to a merger condition that imposes the same exclusivity prohibition. Indeed, despite its far smaller market share and programming assets, the condition imposed upon DIRECTV has no expiration date and applies to both national and regional programming. Although DIRECTV itself owns three RSNs, it has never found this condition to be an impediment to vigorous competition, and is fully prepared to continue operating with this limitation (so long as it applies to cable). The fact that DIRECTV stands to benefit from a sunsetting of the rule yet still feels strongly that it should be extended demonstrates how important cable-affiliated programming remains for successful competition in the MVPD market. On the other hand, the fact that vertically integrated cable operators are so hostile toward the prohibition should raise warning flags.

* * *

The Commission also seeks comment on whether two sets of alternative policies—a "partial" sunset under which the exclusivity prohibition would apply either only in certain markets or only to a subset of "must-have" or "marquee" programming, and reliance on the other, non-sunsetting provisions of the program access rules—could serve as substitutes for the exclusivity prohibition. They cannot. While they certainly could be strengthened, and DIRECTV urges the Commission to do so in any event, they cannot replace the exclusivity prohibition.

Partial Sunset. Applying the exclusivity prohibition in certain markets but not others would be extremely problematic. A market-by-market determination would be dysfunctional for a nationwide video service, such as the two satellite video providers. It is no solution at all to say that DIRECTV can offer its subscribers the USA Network in Washington, DC but not nearby Fairfax County, Virginia, when it offers and markets its programming packages on a nationwide basis.

Limiting the prohibition to certain "marquee" programming is equally problematic. With respect to terrestrially delivered programming, the Commission has distinguished between RSNs and other programming, and the D.C. Circuit has upheld this distinction. While RSNs are "must-have" programming, they are far from the only such programming. Individual national sports and entertainment networks are every bit as valuable, including networks such as HBO that the Commission has recognized as "marquee." As the Commission found in the *Comcast-NBCU* proceeding, moreover, multiple networks sold in a bundle by cable-affiliated programmers can be just as valuable in the aggregate as single, "must have" networks. In the end, the Commission will find it difficult to devise an objective method to identify individual networks to which the exclusivity prohibition should apply.

Other Program Access Provisions. Even less effective would be reliance upon the remaining program access provisions as a substitute for the exclusivity rules. Certainly, it would be wise for the Commission to improve these safeguards by, for example, applying a presumption of harm for RSNs and other "marquee" programming for complaints brought under the general "unfair practices" provision of Section 628(b), and clarifying that the antidiscrimination provision of Section 628(c)(2)(B) can apply to exclusive contracts. Yet, even with such augmentation, these provisions demand that MVPDs devote enormous amounts of time and money (more than *two years* for the recent AT&T and Verizon complaints against Cablevision) to prove harm. The record in this proceeding will demonstrate beyond legitimate doubt that, where cable-affiliated programmers engage in exclusive arrangements with cable operators, there is sufficient basis for the Commission to assume harm will occur. Under these circumstances, it would make no sense at all to require complainant MVPDs, many of whom would have very limited resources compared to their vertically integrated opponents, to demonstrate what the Commission already knows to be the case.

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COMMENTS OF DIRECTV, LLC

DIRECTV, LLC ("DIRECTV") respectfully submits these comments in response to the Commission's Notice of Proposed Rulemaking on whether to retain, sunset, or relax the prohibition on exclusive contracts involving satellite-delivered, cable-affiliated programming, and on potential revisions to the Commission's program access rules.[1] Much has changed in the market for delivery of video programming since the exclusive contract prohibition was enacted by Congress in 1992, and even since it was last extended by the Commission in 2007. Notwithstanding these developments, however, the concerns that prompted Congress to create the program access regime persist in the

[1] *Revision of the Commission's Program Access Rules*, 27 FCC Rcd. 3413 (2012) ("*Notice*").

marketplace, and cable-affiliated programmers continue to have the incentive and ability to favor their affiliated cable operators over competitive multichannel video programming distributors ("MVPDs"), with the predictable result that competition and consumers would be harmed. Accordingly, the exclusive contract prohibition remains necessary to preserve and protect competition and diversity in the distribution of video programming, and it should be extended in its entirety for another five years.

In these Comments, we first briefly review the background of the cable exclusivity prohibition and the legal standard for determining the propriety of extending it yet again. We review developments affecting the multichannel video programming and distribution markets during the five years since the prohibition was last extended, demonstrating the continuing necessity of this important competitive safeguard. We present a theoretical framework for assessing exclusivity in the programming distribution market, to show that cable-affiliated programmers are most likely to withhold programming in precisely the cases where doing so does the most harm to consumers and competition. We review potential alternatives should the cable exclusivity prohibition be allowed to sunset in whole or in part, and find them problematic to implement and insufficient to preserve and protect competition in the program distribution market. We then discuss the potential impact of Commission action in this proceeding on the conditions placed on DIRECTV by the *Liberty Media Order*.

BACKGROUND AND LEGAL STANDARD

Because the *Notice* provides an extensive discussion of the program access regime created by Congress and implemented by the Commission,[2] we provide only an

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[2] *See generally Notice*, ¶¶ 6-16.

abbreviated summary of the most salient aspects here. As part of the Cable Television Consumer Protection and Competition Act of 1992, Congress enacted a number of program access provisions designed to offset the market power enjoyed by incumbent cable operators and thereby promote competition and diversity in the distribution of video programming.[3] At issue in this proceeding is Section 628(c)(2)(D) of the Communications Act, which generally prohibits exclusive contracts for satellite-delivered cable programming or satellite-delivered broadcast programming between any cable operator and any cable-affiliated programming vendor in areas served by a cable operator.[4]

Unlike the broader prohibition in Section 628(b) against unfair acts based on a showing of harm, the cable exclusivity prohibition reflects Congress's determination that exclusive contracts between cable operators and satellite-delivered, cable-affiliated programmers are *implicitly* harmful. It therefore relieves a complaining MVPD of the burden of demonstrating harm.[5] Significantly, this prohibition is not absolute, as Congress gave cable-affiliated programmers the ability to petition the Commission for a determination that a particular exclusive contract would serve the public interest.[6] In this way, Congress crafted a regime in which cable-affiliated programmers would bear the burden of justifying exclusive arrangements with cable operators in all cases, while

3 *See generally* S. Rep. No. 102-92 at 28 (1992); Cable Television Consumer Protection and Competition Act of 1992, Pub L 102-385, § 2(a)(2) ("1992 Cable Act").

4 *See* 47 U.S.C. § 548(c)(2)(D).

5 *See Notice*, ¶ 7 and n.21 (citing cases).

6 *Id.*

complainants would bear the burden of demonstrating that many other "unfair acts" result in sufficient harm to warrant their prohibition in specific instances.

Congress also recognized, however, that its legislative judgment with respect to the harmfulness of cable-affiliated exclusive arrangements might someday be overtaken by new market conditions. Thus, it provided that the provision would sunset in ten years unless the Commission found it "continues to be necessary to preserve and protect competition and diversity in the distribution of video programming."[7] The Commission has twice found that market conditions satisfy this statutory standard. In June 2002, it extended the exclusive contract prohibition for five years (through October 2007).[8] In September 2007, the Commission concluded based on a review of market conditions that the prohibition was still necessary, and extended it for an additional five years (through October 2012).[9] As before, the Commission has now undertaken to conduct a review of prevailing market conditions prior to October 2012 to determine whether the exclusive contract prohibition should be extended yet again.

Section 628(c)(5) instructs the Commission to extend the cable exclusivity prohibition if it finds "that such prohibition continues to be necessary to preserve and protect competition and diversity in the distribution of video programming."[10] In prior

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[7] *Id.*, ¶ 3 (*citing* 47 U.S.C. § 548(c)(5)).

[8] *See Implementation of the Cable Television Consumer Protection and Competition Act of 1992 – Development of Competition and Diversity in Video Programming Distribution*, 17 FCC Rcd. 12124 (2002) ("*2002 Extension Order*").

[9] *See Implementation of the Cable Television Consumer Protection and Competition Act of 1992 – Development of Competition and Diversity in Video Programming Distribution: Sunset of Exclusive Contract Prohibition*, 22 FCC Rcd. 17791 (2007) ("*2007 Extension Order*), *aff'd sub nom. Cablevision Sys. Corp. v. FCC*, 597 F.3d 1306 (D.C. Cir. 2010) ("*Cablevision I*").

[10] 47 U.S.C. § 548(c)(5).

extension proceedings, the Commission has interpreted this mandate as entailing a determination of whether, "in the absence of the prohibition, competition and diversity in the distribution of video programming would not be preserved and protected."[11] If so, Section 628(c)(5) *requires* the Commission to extend the exclusive contract prohibition.[12]

Because the prohibition has been in place since 1992, there is limited direct evidence of anticompetitive foreclosure upon which to rely. Accordingly, in making its extension decision, the Commission considers not only "specific factual evidence" of foreclosure (*e.g.*, withholding of terrestrially delivered programming), but also "economic theory" and the Commission's "predictive judgment."[13]

For the reasons discussed herein, DIRECTV submits that the Commission has ample evidence justifying the extension of the cable exclusivity prohibition in its entirety. Moreover, the alternatives to extension would not satisfy the statutory mandate to preserve and protect competition and diversity in the distribution of video programming. Proposals for a partial sunset would be difficult to implement and ineffectual in practice, while other statutory safeguards remaining after a total sunset would not be sufficient to fill the resulting void. Accordingly, the Commission should extend the prohibition for another five years.

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[11] *2002 Extension Order*, ¶ 14; *2007 Extension Order*, ¶ 13. The D.C. Circuit has affirmed the Commission's statutory interpretation, as well as the Commission's authority to implement further extension so long as the statutory standard continues to be satisfied. *Cablevision I*, 597 F.3d at 1313-14.

[12] *See 2007 Extension Order*, ¶ 13 (finding that Section 628(c)(5) "requires the exclusive contract prohibition to be extended if we find that, in the absence of the prohibition, competition and diversity in the distribution of video programming would not be preserved and protected").

[13] *2002 Extension Order*, ¶¶ 16, 25; *2007 Extension Order*, ¶¶ 13-14.

DISCUSSION

I. CHANGES IN MARKET CONDITIONS SINCE 2007 HAVE NOT DIMINISHED THE NEED FOR THE EXCLUSIVE CONTRACT PROHIBITION

Five years ago, when it last extended the exclusive contract prohibition, the Commission conceded that the record in this area would necessarily always be somewhat incomplete. Because the prohibition has been in effect since 1992, it noted, "it is difficult to obtain specific factual evidence of the impact on competition in the video distribution market if the prohibition were lifted."[14] Nonetheless, it found "specific factual evidence that, where the exclusive contract prohibition does not apply, such as in the case of terrestrially delivered programming, vertically integrated programmers have withheld and continue to withhold programming from competitive MVPDs."[15] Specifically, the Commission discussed evidence from the recently decided *Adelphia* proceeding that the withholding of two cable-affiliated RSNs (Comcast SportsNet Philadelphia and Cox Channel 4 San Diego) had depressed DBS subscription rates by 40 percent in Philadelphia and 33 percent in San Diego.[16] In fact, in response to criticisms of the regression analysis used in *Adelphia*, the Commission revised its methodology and not only confirmed its original conclusion but actually strengthened it in some respects.[17]

In addition, the Commission conducted an analysis from which it concluded that cable subscribership "has not reached a point where withholding would be

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[14] *2007 Extension Order*, ¶ 14.

[15] *Id.*, ¶ 29.

[16] *Id.*, ¶ 39.

[17] *Id.*, ¶ 40 and Appendix B.

unprofitable."[18] Revenues foregone by a cable-affiliated programmer due to withholding can be compensated by the increased revenue its cable affiliate earns from new subscribers, higher affiliation fees paid by noncompeting cable operators, and higher cable rates charged to all subscribers in the absence of robust competition.[19] The Commission calculated that withholding of some nationally distributed networks could be profitable if as little as 1.9 percent of non-cable subscribers were to switch to cable as a result, while withholding of RSN programming would be profitable in many DMAs with high cable market share.[20]

From all of this evidence, the Commission concluded that "withholding programming from rivals can be a profitable strategy for a vertically integrated cable programmer" and that "such practices, in turn, predictably harm competition and diversity in the distribution of video programming, to the detriment of consumers."[21] In this proceeding, the Commission must determine whether market changes in the past five years have rendered its prior findings invalid and the prohibition unnecessary.[22]

The first place to look, of course, is at its own recent decisions in this area. The Commission should give significant weight to the conclusions it has reached based on empirical analysis of data presented in four proceedings over the last five years. Indeed, it must do so in order to fulfill its duty of reasoned decisionmaking. It should also once again examine more generalized data on the status of competition in the relevant markets,

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[18] *Id.*, ¶ 52 and Appendix C.

[19] *Id.*

[20] *Id.*, Appendix C, ¶¶ 20-21.

[21] *Id.*, ¶ 40.

[22] *E.g.*, *id.*, ¶¶ 16-28.

with particular emphasis on the extent to which any changes that have occurred since the prior consideration would make the prohibition more or less necessary. Such quantitative analysis should be expanded somewhat in this proceeding, however, to capture the full range of relevant market dynamics. This investigation will lead to the same conclusion as in 2007: extension of the exclusivity prohibition is necessary.

A. Commission Findings in Recent Proceedings Confirm the Ongoing Need for Safeguards Against Exclusive Arrangements Involving Cable-Affiliated Programming

Substantial evidence generated over the last five years is available for the Commission's consideration in this extension proceeding. In particular, in four proceedings resolved within the last three years, the Commission consistently found evidence that cable-affiliated programmers continue to have the incentive and ability to withhold programming from rival MVPDs, to the detriment of competition and consumers.

1. Closing the Terrestrial Loophole

In the same order that extended the cable exclusivity prohibition of Section 628(c)(2)(D), the Commission also proposed to adopt rules under Section 628(b) that would apply to exclusive arrangements between cable operators and cable-affiliated programmers with respect to programming delivered terrestrially.[23] In 2010, the Commission adopted such rules in order to "provide competitors to incumbent cable operators with an opportunity to obtain access to certain cable-affiliated programming that they are currently unable to offer to subscribers, thereby promoting competition in

[23] *2007 Extension Order*, ¶¶ 114-117.

the delivery of video to consumers."[24] In doing so, the Commission found three bases for its action: (1) cable operators' continuing incentive and ability to engage in unfair acts or practices involving their affiliated programming; (2) confirmation of this conclusion by real-world evidence that vertically integrated cable operators have withheld certain terrestrially-delivered, cable-affiliated programming from their competitors; and (3) the anticompetitive effects of such withholding.[25]

The record in that proceeding included substantial real-world evidence "that cable firms withhold affiliated programming from competitors when not barred from doing so."[26] Among other things, the Commission cited the withholding of RSN programming in Philadelphia and San Diego, HD RSN feeds in New York, news networks, and on-demand programming. The Commission also concluded that cable-affiliated programmers continue to have the incentive and ability to engage in anticompetitive acts because cable's national market share remained high (63.5 percent) and its regional market share was even higher (over 77 percent).[27] It found that such conditions would allow a vertically integrated cable operator the option to "raise the costs of its MVPD competitors by increasing the price of its affiliated programming or . . . [to] choose not to sell its affiliated programming to rival MVPDs."[28] Based on such evidence, the Commission adopted rules to close the "terrestrial loophole," including a presumption

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[24] *Review of the Commission's Program Access Rules and Examination of Program Tying Arrangements*, 25 FCC Rcd. 746, ¶ 1 (2010) ("*2010 Program Access Order*").

[25] *Id.*, ¶ 25.

[26] *Id.*, ¶ 30.

[27] *Id.*, ¶¶ 26-28.

[28] *Id.*, ¶ 26.

that withholding terrestrially-delivered RSN programming has the illicit purpose or effect set forth in Section 628(b).[29]

As if to validate the Commission's action, Cox chose less than one year later not to renew its rights agreement with the San Diego Padres.[30] Obviously, DIRECTV was not party to this decision. Yet it seems reasonable to infer that part of the value of the prior arrangement was the "purpose or effect" of hindering competition, and that Cox was no longer interested in the arrangement once it could not withhold the affiliated RSN from its satellite rivals.

2. *Verizon v. MSG* and *AT&T v. MSG*

The first applications of the *2010 Program Access Order* involved two separate complaints brought by Verizon and AT&T against Cablevision and its Madison Square Garden affiliate for withholding the HD feed of two terrestrially-distributed RSNs, MSG HD and MSG+ HD.[31] Complainants in each case presented substantial evidence of the

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29 *See id.*, ¶ 52.

30 *E.g.*, J. Maffei, "Padres: Fox Sports San Diego Ready to Launch," NORTH COUNTY TIMES (Mar. 7, 2012) (*available at* http://www.nctimes.com/sports/baseball/professional/mlb/padres/padres-fox-sports-san-diego-ready-to-launch/article_243866d5-10fc-585e-82a1-bf42048df760.html). DIRECTV now has access to Padres games through its carriage of Fox Sports San Diego—an RSN not affiliated with any MVPD.

31 *Verizon Tel. Companies and Verizon Svcs. Corp. v. Madison Square Garden, L.P. and Cablevision Sys. Corp.*, 26 FCC Rcd. 13145 (MB 2011) ("*Verizon HD Access Order*"), *aff'd*, 26 FCC Rcd. 15849 (2011) ("*Verizon HD Access Review Order*"); *AT&T Svcs. Inc. and Southern New England Tel. Co. d/b/a AT&T Connecticut v. Madison Square Garden, L.P. and Cablevision Sys. Corp.*, 26 FCC Rcd. 13206 (MB 2011) ("*AT&T HD Access Order*"), *aff'd*, 26 FCC Rcd. 15871 (2011) ("*AT&T HD Access Review Order*"). Although defendants initially filed petitions for review of both proceedings before the Second Circuit, those appeals were subsequently withdrawn.

anticompetitive effects of such withholding, including survey evidence demonstrating the importance of local sports programming to consumers.[32]

Based upon this evidence, the Commission in each proceeding reiterated its prior finding that "an exclusive arrangement harms competition when the network withheld is 'popular' and 'established' and when other MVPDs have expressed an interest in carrying the network."[33] It found substantial evidence that the withholding in question was designed to harm Cablevision's rivals.[34]

By contrast, MSG was unable to show that the asserted procompetitive effects of exclusivity were sufficient to offset the demonstrated anticompetitive impact of withholding, though that assertion had been placed squarely at issue in the proceedings.[35] To the contrary, while defendants claimed that exclusivity had increased their incentives to invest in the programming, they "put forth no evidence demonstrating that this theory motivated their withholding strategy" and "put forth no evidence demonstrating that this withholding strategy has resulted in increased investment in the networks or that it has improved the quantity and quality of programming on the networks."[36]

3. Comcast-NBCU Transaction

Most recently, in connection with Comcast's proposed acquisition of control over the programming assets of NBC Universal, the Commission reached a similar set of

[32] *Verizon HD Access Review Order*, ¶ 7; *AT&T HD Access Review Order*, ¶ 7.

[33] *Verizon HD Access Order*, ¶ 28; *AT&T HD Access Order*, ¶ 29.

[34] *See Verizon HD Access Order*, ¶ 25 (citing Cablevision advertisements highlighting rivals' lack of HD RSN programming); *AT&T HD Access Order*, ¶ 26 (same).

[35] *Verizon HD Access Order*, ¶ 37; *AT&T HD Access Order*, ¶ 38.

[36] *Verizon HD Access Order*, ¶ 33; *AT&T HD Access Order*, ¶ 34.

conclusions with respect to an even broader array of programming.[37] Based on its empirical analysis of confidential data in the record of that proceeding, the Commission determined that the proposed transaction "creates the possibility that Comcast-NBCU, either temporarily or permanently, will block Comcast's video distribution rivals from access to the video programming content the JV would come to control or raise programming costs to its video distribution rivals."[38]

This would be possible, it found, because "the record evidence supports a finding that without Comcast-NBCU's suite of RSN, local and regional broadcast and national cable programming, other MVPDs likely would lose significant numbers of subscribers to Comcast, substantially harming those MVPDs that compete with Comcast in video distribution."[39] Further, it found that "successful exclusion (whether involving complete foreclosure or cost-raising strategies) of video distribution rivals would likely harm competition by allowing Comcast to obtain or (to the extent it may already possess it) maintain market power."[40]

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In each of these recent proceedings, the Commission's review of empirical evidence led to the conclusion that cable-affiliated programmers continue to have the incentive and ability to withhold programming from competitive MVPDs, and that such withholding would injure competition and consumers. Absent dramatic new evidence in

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37 *Comcast Corp., General Electric Co. and NBC Universal, Inc.*, 26 FCC Rcd. 4238 (2011) ("*Comcast/NBCU Order*").

38 *Id.*, ¶ 29.

39 *Id.*, ¶ 37.

40 *Id.*, ¶ 39.

the record, it would be difficult for the Commission to reach a different conclusion here consistent with its obligation to engage in reasoned decisionmaking.[41]

B. Market Structure Developments Since 2007 Further Validate the Commission's Recent Findings

Though the Commission could rely solely on its recent decisions in order to find that its 2007 conclusions remain relevant, it has once again undertaken a broader examination of current market structure. In 2007, while recognizing the procompetitive developments in the MVPD market since its last extension of the cable exclusivity prohibition, the Commission concluded that such developments had not been "significant enough for us to reverse the Commission's previous conclusion that cable operators have market dominance of sufficient magnitude that, in the absence of the prohibition, they would be able to act in an anticompetitive manner."[42] The result here should be the same.

The Commission has prepared a series of summary tables reflecting data from four time periods relevant to the passage and extension of the exclusive contract prohibition.[43] For each of these periods, the Commission sets forth the kinds of data it examined in 2007, such as the number of subscribers attributable to each type of MVPD and the number of satellite-delivered national and regional programming networks

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41 *See, e.g., FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009) (holding that, while an "agency need not always provide a more detailed justification than what would suffice for a new policy created on a blank slate," it must do so "when, for example, its new policy rests upon factual findings that contradict those which underlay its prior policy," and continuing that, in such cases "a reasoned explanation is needed for disregarding facts and circumstances that underlay or were engendered by the prior policy").

42 *See 2007 Extension Order*, ¶ 50 and n.269 (providing tables (1) as of 1994 (from the *First Annual Report*); (2) as of June 2001 (from the *Eighth Annual Report*); (3) as of June 2005 (from the *Twelfth Annual Report*); and (4) as of the most recent period available).

43 *Notice*, Appendix A.

affiliated and not affiliated with a cable operator. We review each of these in turn, as well as what the Commission may anticipate in the future.

In this regard, it is important for the Commission to recognize that consumers increasingly demand broadband Internet access and voice service along with their video services—a factor that was not even considered in past extension analyses. Such "triple play" offerings have had an enormous effect on MVPD market dynamics, including cable's market share. DBS operators, who do not have their own broadband facilities, increasingly find themselves at a distinct disadvantage, especially in the limited areas where telco providers have deployed fiber and in the much more extensive areas where cable operators have deployed capacity-enhancing technology such as DOCSIS 3.0. Not surprisingly, in areas outside the limited telco video footprint where DBS is the primary competition, cable's share of total TV households has declined much more slowly since the last Commission review in 2007. Specifically, between 2007 and 2011, cable's market share declined by 11.4 percent in areas where wireline-based competitors entered, compared with a decline of only 4.3 percent in areas where they did not. The corresponding changes since 2008 are 9.6 percent and 1.5 percent.[44] Thus, in the majority of the country where telco systems do not offer service, cable's market share has largely stabilized. As broadband service continues to gain importance, cable operators will increasingly be able to use the advantage of bundled services to slow or even reverse losses in video subscribership.

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[44] Centris National Tracking Study, 2007q1-2011q1.

Overall, the data show that changes in the marketplace once again "present[] a mixed picture."[45] This is exactly the situation in which conclusions based on the Commission's predictive judgment and technical analysis are not only appropriate, but critical. Taken as a whole, the data show that the cable exclusivity prohibition is still necessary under current market conditions.

1. Cable Market Share and Concentration

In both 2002 and 2007, the Commission found the high market share of cable operators in general, and the high concentration among the largest cable multiple system operators ("MSOs") in particular, supported the conclusion that extension of the cable exclusivity prohibition was necessary.[46] While the Commission's summary of national cable market share and concentration metrics in Appendix A is useful to such an analysis, DIRECTV believes that it could be revised to reflect additional salient information.

Set forth in Table 1 below is a slight variation on Appendix A. It essentially replicates the last two rows of the table in Appendix A, with four revisions. First, in order to achieve a more consistent timeline relevant to market conditions at the time the cable exclusivity prohibition has been considered, it uses data as of June 2006 from the *Thirteenth Annual Report*. Second, it uses NCTA data as of the end of 2011 for the "Most Recent" column.[47] Third, it shows data not only for the top 4 cable MSOs, but for the top 2 and top 3 MSOs as well. Fourth, it combines the last two rows of Appendix A

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45 *Cablevision I*, 597 F.3d at 325.

46 *2002 Extension Order*, ¶ 45; *2007 Extension Order*, ¶ 50.

47 Figures for individual cable operators were obtained from National Cable & Telecommunications Association, "Top 25 Multichannel Video Programming Distributors as of Dec. 2011" (*available at* http://www.ncta.com/Stats/TopMSOs.aspx). The market share was then calculated using the same estimated number of total MVPD subscribers (99.645 million) as the Commission did. *See Notice*, Appendix A, n.17.

to reflect the market share of the top MSOs that are vertically integrated if that figure is different from the overall market share.

National Market Share and Concentration. As Table 1 shows, the combined national market share held by all cable operators continues to decrease at a slow pace. Nonetheless, cable operators continue to hold a dominant share of MVPD subscribers nationwide (58.5 percent), though this is less than the share considered by the Commission in 2007 (67 percent) and 2010 (63.5 percent).

# of MVPD subscribers receiving video from one of the:	First Annual Report[48]	Eighth Annual Report[49]	Thirteenth Annual Report[50]	Most Recent
Top 2 MSOs (VI, if different)	37.28%	30.79% (23.88%)	39.05%	34.53%
Top 3 MSOs (VI, if different)	42.36%	40.32% (30.86%)	45.22% (44.69%)	39.30%
Top 4 MSOs (VI, if different)	47.18%	47.67% (34.26%)	50.86% (47.89%)	43.64%

Table 1. Cable Share of Nationwide MVPD Subscribership

However, the market share of the largest individual cable operators (*i.e.*, national cable *concentration*) is not materially different from concentration levels in 1994, 2001,

48 *Implementation of Section 19 of the Cable Television Consumer Protection and Competition Act of 1992*, 9 FCC Rcd. 7442, Appendix G, Table 1 (1994).

49 *Annual Assessment of the Status of Competition in the Market for Delivery of Video Programming*, 17 FCC Rcd. 1244, Appendix C, Table C-3 (2002).

50 *Annual Assessment of the Status of Competition in the Market for Delivery of Video Programming*, 24 FCC Rcd. 542, Appendix B, Table B-3 (2009). All figures in this column combine Adelphia's market share with that of Comcast and Time Warner Cable, which is consistent with the approach taken by the Commission in 2007. *2007 Extension Order*, ¶ 54.

and 2006. More than one in three MVPD subscribers continues to receive video programming from the two largest cable MSOs, both of which are vertically integrated. This reflects greater concentration (and far greater concentration within the top vertically integrated MSOs) than was the case when the Commission extended the cable exclusivity prohibition in 2002. Nearly four in ten subscribers receive service from the three largest cable MSOs, all of which are vertically integrated. Here again, this level is nearly the same as in 2002, and the concentration among the top vertically integrated MSOs is much higher today.

The continued dominant position of cable is particularly significant because cable operators can leverage their market power collectively through "cable-only" exclusives.[51] Incumbent cable operators do not compete against each other, as they operate in separate franchise areas. As the Commission has recognized, a cable-affiliated programmer has the incentive to withhold programming from non-cable rivals while selling it to other cable operators with which it does not compete.[52] Cable-only exclusives increase the feasibility of withholding programming by decreasing the number of foreclosed entities. Thus, even if no single cable operator possesses sufficient market power to make an exclusive arrangement profitable, groups of the largest cable operators may well possess sufficient market power.

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[51] Technically, a cable-only exclusive is merely a series of contracts between a programmer and multiple cable operators, each providing exclusivity within a cable operator's franchise area.

[52] *Adelphia Communications Corp., Time Warner Cable Inc., and Comcast Corp.*, 21 FCC Rcd. 8203, ¶ 120 (2006) ("*Adelphia Order*") ("Because cable operators serve discrete franchise areas and generally do not compete against each other within franchise areas, a cable operator could narrowly target a foreclosure strategy to harm only its rivals by crafting exclusive distribution agreements that permit adjacent, non-rival cable operators to carry the affiliated programming and that exclude the programming only from rival firms competing in the cable operator's service areas.").

In this regard, it is worth noting that such coordinated activity among incumbent cable operators has become increasingly prevalent. For example, as part of a transaction in which they are selling Advanced Wireless Services licenses to Verizon Wireless, Comcast, Time Warner Cable, Cox, and Bright House agreed to create an Innovation Technology Joint Venture to pool their resources in order to develop ways to integrate wireline and wireless services.[53] These same MSOs, joined by Cablevision, also recently announced CableWiFi, a collaborative effort under which they will allow each other's customers access to all of their WiFi hotspots.[54] As such joint initiatives become more common, coordination in the form of cable-only exclusives becomes easier to execute.

Regional Market Share. In addition, as the Commission notes, regional concentration in many major metropolitan areas (including New York, Boston, Philadelphia, and Washington, DC) remains much higher, with market share in the 80 percent range in some cases.[55] This high level of regional concentration reflects the continued trend of cable system "clustering." Cable's continued regional concentration is more important than its decrease in nationwide concentration with respect to incentives for regional and local programming.[56] Moreover, the ability to deliver or deny distribution for national programmers in some of the nation's largest urban areas gives clustered cable operators significant leverage in that arena as well.

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[53] *See, e.g.*, Press Release, "Comcast, Time Warner Cable, and Bright House Networks Sell Advanced Wireless Spectrum to Verizon Wireless for $3.6 Billion" (Dec. 2, 2011) (*available at* http://www.cmcsk.com/releasedetail.cfm?ReleaseID=629615).

[54] *See, e.g.*, Press Release, "Major U.S. Cable Companies Join Forces on WiFi," YAHOO! FINANCE (May 21, 2012) (*available at* http://finance.yahoo.com/news/major-u-cable-companies-join-100000756.html).

[55] *See Notice*, ¶ 24.

[56] *See Comcast/NBCU Order*, Appendix C, ¶¶ 7-20.

2. Vertical Integration

With respect to vertical integration of programming, there have been two transactions of particular note since 2007 involving cable-affiliated programmers. First, programmer Time Warner, Inc. separated from distributor Time Warner Cable, making all Time Warner programming (but not Time Warner Cable's affiliated RSNs) no longer subject to the program access rules.[57] Second, Comcast acquired control over the programming assets of NBC Universal, which had previously been non-cable affiliated.[58] The net effect of these transactions can best be described as a rearrangement of the competitive landscape rather than a wholesale revision, as the removal of Time Warner networks from the cable-affiliated column was largely offset by the addition of NBCU networks.

National Networks. As summarized in Table 1 of Appendix B to the *Notice*, the number of satellite-delivered national networks has continued to grow at a rapid pace.[59] As the Commission found in 2007, however:

> What is most significant to our analysis is not the percentage of total available programming that is vertically integrated with cable operators, but rather the popularity of the programming that is vertically integrated and how the inability of competitive MVPDs to access this programming will affect the preservation and protection of competition in the video distribution marketplace.[60]

57 *See Time Warner Inc. and Time Warner Cable Inc.*, 24 FCC Rcd. 879 (MB, WCB, WTB, IB 2009).

58 *See generally Comcast/NBCU Order*.

59 DIRECTV agrees that the Commission's methodology of counting SD and HD networks separately is appropriate, given its prior conclusion that consumers do not consider the SD version of a channel to be an adequate substitute for the HD version. *See 2010 Program Access Order*, ¶¶ 54-55. The Commission has not reached a similar conclusion with respect to 3D and VOD programming, so those versions should not be counted separately.

60 *2007 Extension Order*, ¶ 37. *See also 2002 Extension Order*, ¶ 33

Thus, it is largely irrelevant that there is one fewer cable-affiliated national programming network today than there was in 2007, or that the explosion in the number of non-affiliated national programming networks has decreased the overall share of cable-affiliated programmers.[61] Rather, the focus should be on the fact that today, 7 of the Top 20 most widely distributed national programming networks are affiliated with a cable operator, compared to only 6 in 2007, and that the same number of Top 20 highest rated national programming networks are cable-affiliated today as were in 2007.[62] Indeed, approximately 27 percent of the national video networks that comprise DIRECTV's most popular tier of service (Choice XTRA) are cable-affiliated.[63] As the Commission put it in 2002, "[f]ailure to secure even a portion of vertically integrated programming would put a nonaffiliated cable operator or competitive MVPD at a significant disadvantage vis-à-vis a competitor with access to such programming."[64]

Moreover, cable-affiliated programmers generally offer national networks under common control as a package, as the Commission recognized in the Comcast/NBCU proceeding. The networks in such packages may, in the aggregate, constitute "marquee" programming even if the individual components do not. Thus, the loss of several networks might have a dramatic effect on an MVPD's subscribership, even if the loss of

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61 "The availability of new, non-integrated networks does not mitigate the adverse impact on competition of a competitive MVPD's inability to access popular vertically integrated programming." *2007 Extension Order*, ¶ 38.

62 *Notice*, Appendix B, Table 1.

63 *Compare Notice*, Appendix B, Table 2 (listing cable-affiliated national networks) *with* DIRECTV Channel Lineups (*available at* http://www.directstartv.com/pdf/chnllineup.pdf).

64 *2002 Extension Order*, ¶ 32.

any one network alone might not.[65] The Commission's empirical analysis in *Comcast/NBCU* "suggests that the overall bundle of NBCU cable networks is critical programming that MVPDs need to offer a competitive service that is attractive to consumers even if no individual network in the bundle were considered 'marquee' programming."[66] While this is not a new phenomenon, it is one that the Commission did not previously consider in its extension analysis.[67]

Regional Sports Networks. The Commission has identified RSN programming as critical to any MVPD offering.[68] It is therefore notable that the number of cable-affiliated regional sports networks has increased substantially since 2007, both in raw number (going from 18 to 57) and in percentage terms (going from 46% to 52.3%).[69]

Future Vertical Integration. In the *Adelphia* proceeding, the Commission concluded that the question of vertical integration is not merely a snapshot in time. Rather, depending on market conditions, cable operators can acquire new programming that, in turn, can be used anticompetitively. The *Adelphia* Order focused particularly on

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65 *See*, *e.g.*, *Comcast-NBCU Order*, ¶ 139 (noting that "the bundle of NBCU cable networks may collectively constitute marquee programming, much as the NBC broadcast network does on its own" and "[i]f so, the combination of the NBCU cable networks with Comcast's RSNs would bring together marquee programming and, consequently, potentially increase Comcast-NBCU's bargaining power over that collection of programming when negotiating with MVPDs").

66 *Comcast/NBCU Order*, Appendix B, ¶ 46.

67 Despite the current applicability of merger conditions that prohibit Comcast-affiliated programmers from engaging in exclusive arrangements, the Commission must consider those programmers in its analysis here. Although those conditions do not expire until after the extension under consideration, they do expire soon thereafter. But if the Commission decided now, based on an analysis of the market that ignored Comcast programming, it would have no vehicle to consider whether the prohibition was necessary at that later time. Doing so would be analogous to agreeing to disarm forever based on a treaty under which the opponent may retain its army but agrees not to attack over the next five years.

68 *E.g., 2007 Extension Order*, ¶ 34.

69 *Notice*, Appendix C, Table 1.

RSN programming, concluding that Comcast and Time Warner Cable could be expected to acquire sports rights and form RSNs in areas where they had created large clusters of subscribers.[70] This prediction has already been borne out, as demonstrated by Time Warner Cable's formation of two new RSNs serving its Los Angeles cluster and Comcast's formation of new RSNs serving its Portland and Houston clusters. It would take but a small exercise of predictive judgment for the Commission to conclude that more cable-affiliated RSNs can be expected in the future, especially as the largest MSOs continue to cluster.[71]

This concern also applies, however, with respect to national programming. "Video programming has evolved over time—today certain national cable programming networks produce programming that is more widely viewed and commands higher advertising revenue than certain broadcast or RSN programming."[72] Thus, while ESPN is not cable-affiliated (and has never been withheld), the Commission must consider the possibility that a cable operator and Disney might engage in a transaction through which ESPN would become cable-affiliated.[73] More likely yet is the possibility that that cable-

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70 *See Adelphia Order*, ¶ 127 ("Our analysis extends beyond those markets where the Applicants currently own RSNs. As DIRECTV has noted, the Applicants' expanded regional clusters may provide them with an increased incentive and ability to launch their own RSNs in those areas.").

71 *See, e.g., Insight Communications and Time Warner Cable,* 27 FCC Rcd. 497 (2012) (authorizing acquisition of approximately 643,000 subscribers to augment existing cable cluster in the Midwest).

72 *Comcast/NBCU Order*, ¶ 46.

73 Such a transaction could take the form of Disney acquiring an interest in a cable company, or a cable company acquiring an interest in Disney's programming assets, as Comcast once tried to do. *See* Press Release, "Comcast Corporation Makes Proposal to Merge with The Walt Disney Company" (Feb. 11, 2004) (*available at* http://www.comcast.com/About/PressRelease/PressReleaseDetail.ashx?PRID=261&SCRedirect=true).

affiliated programmers will create national sports networks to compete directly with ESPN. Indeed, ever since Comcast announced its acquisition of NBCU, there has been an expectation that it would use the NBC Sports platform as a springboard to launch just such a competing channel.[74] Likewise, the Commission must consider the possibility that, in the absence of an exclusivity prohibition, "marquee" networks like HBO might become vertically integrated (or, in HBO's case, return to such status)—subjecting them to the incentives for anticompetitive activity that come along with cable affiliation.[75]

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Taken together, this evidence compels the same conclusion that the Commission reached in 2007: "cable-affiliated programming continues to represent some of the most popular and significant programming available today."[76]

3. Bundling of Services

One significant development that has accelerated since 2007 is the extent to which cable operators bundle additional services with their video offerings. The "triple play" of video, broadband, and voice services is now a familiar combination made available to consumers. Some cable operators have expanded into a "quad play" with the addition of wireless services, a trend that is likely to increase significantly under the joint marketing

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74 *See, e.g.*, "Versus Could Compete With ESPN Under Comcast's NBC Acquisition," SPORTSBUSINESS DAILY (Dec. 2, 2009) (*available at* http://www.sportsbusinessdaily.com/Daily/Issues/2009/12/Issue-56/Sports-Media/Versus-Could- Compete-With-ESPN-Under-Comcasts-NBC-Acquisition.aspx); Bob Fernandez, "Comcast's NBC Sports to launch radio network, compete with ESPN," PHILLY.COM (Jun. 13, 2012) (*available at* http://www.philly.com/philly/business/158493425.html).

75 *Adelphia Order*, ¶ 42 (*citing 2002 Extension Order*, ¶ 69 (recognizing that "certain programming services, such as sports programming, or marquee programming, such as HBO, may be essential and for practical purposes, 'must haves' for program distributors and their subscribers . . . .")).

76 *2007 Extension Order*, ¶ 37.

agreements recently entered into between the nation's largest cable MSOs (Comcast, Time Warner Cable, Cox, and Bright House) and its largest wireless carrier (Verizon Wireless).[77] Bundling was not even mentioned in the *2007 Extension Order*, but its importance to the analysis of current market conditions cannot be overstated.

For example, bundling changes the factors that determine the profitability of withholding programming from rival MVPDs by significantly increasing the value of a cable subscriber. As the Commission has determined, withholding will be profitable (and therefore rational) for a vertically integrated cable operator if the carriage and advertising fees lost by its programming arm are more than offset by the additional revenue earned by its distribution arm from subscribers who switch from the foreclosed rival.[78] The greater the revenue generated by each new subscriber, the easier it is for this equation to justify withholding. This is precisely the effect bundling has, because subscribers who pay for two or more services generate more revenue for a cable operator than do those who take video only.

A review of Comcast's cable segment operational data from December 2006 and December 2011, set forth in Table 2 below, reflects the impact of increased penetration of bundled services over the last five years. Over that period, average total revenue per video subscriber (from video, broadband, and voice combined) rose from $95 to $137—

[77] News Release: "Comcast, Time Warner Cable, And Bright House Networks Sell Advanced Wireless Spectrum To Verizon Wireless For $3.6 Billion," (Dec. 2, 2011), *available at* http://news.verizonwireless.com/news/2011/12/pr2011-12-02.html.

[78] *See, e.g., Comcast-NBCU Order*, Appendix B., ¶ 6 ("The model assumes that an integrated firm will foreclose a rival from access to an input if the increased profits it earns in the downstream market from foreclosure exceed the losses it incurs from the lost sales of the input to the rival firm.").

an increase of over 44 percent.[79] By comparison, average revenue per subscriber for DIRECTV and DISH Network (two video-only providers) was both much smaller and increased more slowly.[80]

MVPD	December 2006	December 2011	Change
Comcast[81]	$95.00	$137.00	44.2%
DIRECTV[82]	$73.74	$93.27	26.5%
DISH Network[83]	$62.47	$76.93	23.1%

Table 2. Comparison of Average Monthly Revenue Per Video Subscriber

79 *See* Comcast 1Q12 10-Q at 29; Comcast 2006 Annual Report at 30 (Feb. 26, 2007) (available at http://files.shareholder.com/downloads/CMCSA/1922203650x0xS1193125-07-39301/1166691/filing.pdf).

80 Even for MVPDs that can offer their own "triple play," the Commission has found that the ability to offer these additional services does not reduce the importance of program access: "There is no empirical data in the record to support the claim that bundling of video, voice, data and wireless service shrinks the importance of HD RSNs to consumers in selecting a video provider." *Verizon HD Access Order*, ¶ 64; *AT&T HD Access Order*, ¶ 65.

81 *See* Comcast Corp., Form 10-K for period ending Dec. 31, 2011, at 50 (*available at* http://files.shareholder.com/downloads/CMCSA/1922203650x0x561695/79426950-eb48-4e46-a761-f999d155a226/BookmarkedComcast10K.pdf); Comcast Corp., Form 10-K for period ending Dec. 31, 2007, at 25 (*available at* http://files.shareholder.com/downloads/CMCSA/1922203650x0xS1193125-08-34239/1166691/filing.pdf).

82 *See* DIRECTV, Form 10-K for period ending Dec. 31, 2011, at 41, 45 (*available at* http://files.shareholder.com/downloads/DTV/1807683322x0x554314/10371236-905D-4AC2-B42A-36E4FBD4F1E7/Directv_2011_Annual_Report_Updated_As_Printing.pdf); The DIRECTV Group, Inc., Form 10-K for period ending Dec. 31, 2006, at 48 (*available at* http://files.shareholder.com/downloads/DTV/1807683322x0x154801/28839653-0343-4BE6-8358-DEC28618DDF2/2006AR.pdf).

83 *See* DISH Network Corp., Form 10-K for period ending Dec. 31, 2011, at 46 (*available at* http://files.shareholder.com/downloads/DISH/1930987999x0xS1104659-12-11853/1001082/filing.pdf); EchoStar Communications Corp., Form 10-K for period ending Dec. 31, 2006, at 38 (*available at* http://files.shareholder.com/downloads/DISH/1930987999x0xS950134-07-4460/1001082/filing.pdf).

As bundling continues to become more prevalent, it will make subscribers increasingly valuable to cable operators and widen the gulf in their value to competing MVPDs, resulting in even greater incentive for cable-affiliated programmers to withhold.

II. APPLYING ECONOMIC THEORY TO THE EMPIRICAL EVIDENCE DEMONSTRATES THE CONTINUING NEED FOR RETENTION OF THE CABLE EXCLUSIVITY PROHIBITION

Because the cable exclusivity prohibition has been in place for two decades, the Commission must to a large extent rely upon economic theory and its own predictive judgment to determine what would likely happen in the absence of that prohibition. In making such judgments, it is useful to observe what has happened under the current regulatory regime.

Although cable operators are free to enter into exclusive arrangements with non-cable affiliated programmers, and non-cable MVPDs are free to enter into exclusive arrangements with any programmer (including one affiliated with cable),[84] such arrangements remain exceedingly rare. Indeed, rather than seeking exclusive carriage of non-affiliated programming, large cable operators have recently been fighting to *deny or limit* carriage rights (even for sports programming).[85] Moreover, although cable operators and their affiliated programmers have the ability to petition the Commission at any time for relief from the cable exclusivity prohibition where a particular arrangement

[84] The lone exception is DIRECTV, which is subject to conditions that limit its ability to enter into exclusive arrangements with affiliated programmers.

[85] *See, e.g.*, *The Tennis Channel, Inc. v. Comcast Cable Commc'ns, LLC*, 26 FCC Rcd. 17160 (ALJ 2011) (Initial Decision finding carriage discrimination); *NFL Enter. LLC v. Comcast Cable Commc'ns, LLC*, FCC 09M-42 (rel. May 19, 2009) (dismissing settled claim over carriage complaint); *Game Show Network, LLC v. Cablevision Systems Corp.*, Hearing Designation Order, DA 12-739 (MB, rel. May 9, 2012) (Hearing Designation Order for carriage discrimination complaint); *Herring Broad., Inc. d/b/a WealthTV v. Time Warner Cable, Inc., et al.*, 26 FCC Rcd. 8971 (2011) (denying carriage discrimination complaint).

would serve the public interest, only ten such petitions have ever been filed, none in the last fourteen years.[86] Strikingly, just about the only circumstance in which one *does* find exclusivity involves cable-affiliated RSNs not covered by the cable exclusivity prohibition (because of terrestrial delivery). In those circumstances, however, withholding is almost always found.

Economic theory can help explain this curious set of circumstances. As the Commission has noted, economic theory recognizes that exclusive arrangements can arise from both procompetitive and anticompetitive motivations and can have both types of results.[87] The Commission has used economic models to predict the likelihood of withholding in a number of cases, most recently the Comcast/NBCU transaction. In that proceeding, Commission economists employed a bargaining model (first introduced into the proceeding by Professor Kevin Murphy) to determine the likely magnitude of any post-transaction price increases, based upon the expected gain in subscribers to Comcast cable if Comcast-affiliated programming were withheld from a rival MVPD and the profits earned by Comcast on each such subscriber.[88] They found that Comcast would have the incentive and ability to use its programming assets to disadvantage rival MVPDs, and imposed conditions to assure continued access on fair and non-discriminatory terms.

To further enhance the economic evidence available for consideration in this proceeding, attached hereto as Exhibit A is a report prepared by Professor Murphy that

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[86] *See Notice*, ¶ 8 and n.28 (citing cases).

[87] *See, e.g., Verizon HD Access Order*, ¶ 37; *AT&T HD Access Order*, ¶ 38 (each summarizing earlier Commission findings on this point).

[88] *Comcast-NBCU Order*, Appendix B, ¶¶ 39-46.

builds upon the framework used to analyze the competitive effects of the Comcast/NBCU transaction.[89] It discusses the economic theory of exclusivity, including both the potential procompetitive and anticompetitive implications of exclusive distribution arrangements. Applying that theory to the limited real-world examples of programming exclusivity, he concludes that the efficiency-enhancing rationales for exclusivity are unlikely to motivate exclusive programming arrangements with MVPDs, while the ability of cable-affiliated programmers with high value content to use withholding to weaken competition would be sufficient to make withholding profitable in some cases. Moreover, *cable-affiliated programmers will find it in their interest to withhold precisely in those cases where withholding has the worst price impacts for consumers*. Below we walk through the analysis in more detail.

Professor Murphy begins by noting that a common method that economists use to evaluate whether contracting and other business practices enhance efficiency is to see if they are widely used: if so, they are presumed to have an efficiency rationale (in the absence of market power); if not, they likely do not. Thus, if exclusive program carriage arrangements were economically efficient, one would expect program suppliers that are not subject to the cable exclusivity prohibition to use them. However, as discussed above, such exclusive arrangements (1) are very rare in general; and (2) are employed primarily by cable-affiliated programmers, for whom exclusivity is less necessary to achieve efficiencies. This alone suggests that such arrangements have a very limited efficiency rationale.[90]

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[89] *See* Kevin M. Murphy, "Report of Professor Kevin M. Murphy" (June 22, 2012) ("Murphy Report") (attached hereto as Exhibit A).

[90] *Id.* at 8-10.

As Professor Murphy explains, the rarity of exclusive program distribution arrangements corresponds with the particular characteristics of the MVPD market. Exclusive arrangements can have procompetitive effects by aligning the parties' incentives and thereby creating incentives for the distributor to expand the customer base, preventing free riding on promotional efforts, and facilitating negotiation of lower prices. An important feature of many procompetitive exclusive vertical arrangements is that they do not limit end-users' access to the product and thus achieve other efficiencies at low cost in terms of customer access. Rather, they simply concentrate distribution in a way that creates value without restricting access.[91]

Thus, for example, a beer company that chooses an exclusive wholesale distributor for its product within a specified geographic area (such as Capital Eagle for Budweiser in Washington D.C.) does not do so to limit the availability to consumers, but rather to create incentives for the distributor to expand its marketing efforts in order to sell more beer to more consumers (*i.e.*, increase output). By contrast, it is rare to find a beer company that chooses to be distributed through only a single retailer in a given area, as that would limit the customers to stores in which that beer could be sold. (Budweiser, for example, is not sold only in Safeway.) Customers are unlikely to choose a multiproduct retailer such as a supermarket based only on the brand of beer it carries, so dealing with only one supermarket could significantly restrict customer exposure (and therefore sales).

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[91] *Id.* at 10-14.

Professor Murphy observes that MVPD exclusives, by contrast, nearly always *reduce* end-user access to the product.[92] The loss of access generally reduces efficiency and would have to be offset by another benefit, such as enhanced investment or service, or by better pricing (that would expand overall output) from the exclusive MVPD. However, the nature of MVPD services makes it unlikely that these sorts of efficiencies would arise through exclusive dealing.[93] Moreover, precisely because programmers covered by the exclusivity ban are vertically integrated, they can obtain such "offsetting benefits" *without* exclusivity. This is because vertical integration is itself a substitute for exclusivity as a way to align the incentives of supplier and distributor.[94] Professor Murphy concludes that, "[t]aken together, these factors imply that there likely is little benefit from MVPD exclusives and non-trivial costs in lack of access to customers."[95] The evidence that non-cable affiliated programmers rarely use exclusive distribution arrangements provides empirical support for Professor Murphy's analysis.

The Commission has found in previous analyses that, all else equal, a cable-affiliated programmer's incentive to withhold is greater when (1) its affiliated cable

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92 Professor Murphy also discusses one exclusive arrangement that is a prominent anomaly in this regard: DIRECTV's NFL Sunday Ticket. Unlike most exclusives in this industry, the NFL is not required to forego all revenue from customers that receive service from other MVPDs. The NFL can recapture some of the lost revenue in the form of advertising revenue earned on the broadcast networks that carry games at the same time as the programming provided through Sunday Ticket, perhaps to such an extent that it would be costly rather than beneficial to have broad distribution of Sunday Ticket. "Essentially, Sunday Ticket can be thought of as a vertical product differentiation in which the program supplier (the NFL) provides the major substitute for its own product." *Id.* at 29. Other practical considerations also provide incentives for this exclusive arrangement, including DIRECTV's demonstrated prowess at marketing such programming, its initial technological advantages, and subsequently its installed base of Sunday Ticket subscribers. *Id.* at 30.

93 *Id.* at 16-17.

94 *Id.*

95 *Id.* at 18.

operator has large market share (because it forgoes fewer subscribers), (2) the programming has lower advertising revenues (because it forgoes less advertising revenue), and (3) the diversion rate of subscribers willing to change MVPDs to gain access to the programming is high.[96] In order to more fully evaluate the incentives that would lead a cable-affiliated programmer to withhold programming from rival MVPDs, Professor Murphy creates an economic model of bargaining that builds on the framework used in the Comcast/NBCU proceeding to analyze the competitive effects of vertical integration.

In his simplified model, there is one programming supplier and two MVPDs (call them "Cableco" and "Satco" for ease of reference), only one of which (Cableco) has access to the programming at issue. The analysis first develops equations to quantify the payoffs among the programmer and Satco (1) in the case of vertical integration, and (2) in the case without vertical integration. Comparing the "gains from trade" under these two scenarios illustrates the differences in incentives and the resulting differences in conduct.

The model shows that, under reasonable assumptions, gains from trade will be positive in the non-affiliated case whenever the number of subscribers to the two MVPDs does not decrease (*i.e.*, whenever there is a market expanding effect from increased access). Those gains are reduced, however, in the vertically integrated case due to the downward pressure on Cableco's prices caused by Satco's improved programming lineup.[97] This thus confirms that cable-affiliated programmers have an incentive to withhold programming from competing MVPDs in many situations where non-cable

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[96] *E.g.*, *Comcast/NBCU Order*, Appendix B, ¶¶ 7-9.

[97] Murphy Report at 24-25.

affiliated programmers do not.[98] It also confirms that, to the extent cable operators are able to increase the value of each subscriber by bundling services into a double-, triple-, or even quad-play, their incentive to withhold affiliated programming (and thereby drive subscriber switching) also increases.[99]

The model also indicates that withholding by a cable-affiliated programmer is most likely when, *inter alia*, the competitive impact of licensing on MVPD prices is large. This is because, in such cases, rival MVPDs compete aggressively once they get access to programming and the vertically integrated cable operator is forced to respond by reducing prices.[100] The mechanism for this dynamic can be illustrated with the following simple example. If Satco does not have access to an RSN's programming but Cableco does, presumably (all else equal) Cableco can charge a higher price to subscribers because it has a higher quality product. If Satco later gets access to the RSN programming and thus raises the quality of its offering, it could choose to simply raise its price to meet that charged by Cableco. *Or it could raise its price to a lesser degree in order to take its gains in the form of more subscribers*. In the latter case, Cableco would likely respond by lowering its price to meet the competition from Satco. This is a procompetitive outcome, because total output has increased among the combined subscribership of Cableco *and* Satco and consumers benefit from the more aggressive MVPD competition.

Empirical evidence suggests that this latter, procompetitive outcome will be likely where programming is not withheld. For example, Professor Murphy discusses studies

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98 *Id.* at 22-25.

99 *Id.* at 25-26.

100 *Id.* at 26-27.

showing that once DIRECTV was able to offer local-into-local service to subscribers (ending a *de facto* cable exclusive on local broadcast programming), it took the vast majority of its gains from the associated increase in demand in the form of increased subscribership rather than higher prices.[101]

From all of this, Professor Murphy concludes:

> Vertically integrated programmers will find it in their interest to withhold precisely when withholding has the worst price impacts for consumers, *i.e.*, in those cases where the prices of the vertically integrated MVPD would fall the most and its competitor's prices would increase the least if the rival MVPD had access to the programming. The competitive conditions where extending the cable exclusivity prohibition likely will benefit consumers the most through price competition are those where the vertically integrated firm has the greatest incentive to refuse to license.[102]

RSNs clearly fall into the category of programming that can have the required impact on MVPD pricing, but so can other networks that viewers find attractive. Moreover, bundles of networks that collectively create large value for viewers could also be withheld in a block to achieve the same effect.[103]

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In sum, Professor Murphy's analysis demonstrates that: (1) there is little evidence that cable-affiliated withholding has justification in economic efficiency; (2) economic theory suggests that cable-affiliated withholding is instead driven by value-capture incentives; and (3) withholding by cable-affiliated programmers is most likely in precisely those cases where it is most detrimental to competition and consumers. In such circumstances, it makes far more sense for the Commission to maintain the existing legal

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[101] *Id.* at 31-32.

[102] *Id.* at 28.

[103] *Id.* at 28-29.

structure, in which the harm from cable-affiliated exclusives is presumed and the cable-affiliated programmer bears the burden of demonstrating that a particular arrangement is not harmful—rather than relying upon alternate arrangements in which the burden falls to a complainant MVPD to demonstrate harm.

III. IMPLEMENTING A PARTIAL SUNSET WOULD BE BOTH PROBLEMATIC IN CONCEPT AND INEFFECTUAL IN PRACTICE

The *Notice* seeks comment on several "partial sunset" alternatives to retaining the existing prohibition, under which the Commission would maintain the restriction in certain circumstances rather than sunset it in its entirety.[104] In particular, the *Notice* focuses on the possibility of sunsetting the exclusivity prohibition (1) on a market-by-market basis, or (2) with respect to programming other than RSNs and other "must have" programming. As discussed below, each would create implementation difficulties, and neither would preserve and protect competition and diversity in the distribution of video programming.

A. Market-by-Market Determinations

The *Notice* seeks comment on allowing a cable operator or cable-affiliated programmer to file a "Petition for Sunset" seeking to remove the exclusive contract prohibition on a market-by-market basis where there is sufficient competition in the market. Such an approach would be unworkable for competing MVPDs.

Of most immediate concern to DIRECTV, a market-by-market sunset mechanism would not comport with the realities of how cable's rivals purchase and distribute programming. Cable operators purchase programming for distribution within their

[104] *Notice*, ¶¶ 68-80.

franchise areas, and thus would not be affected by an exclusive arrangement granted to another cable operator in a non-overlapping franchise. DBS operators, by contrast, purchase and distribute programming both nationally and regionally. Were the Commission to allow exclusivity on a market-by-market basis, it would make "Swiss cheese" of a DBS operator's distribution capabilities, creating a logistical, marketing, and customer relations nightmare.

Suppose, for example, Comcast were allowed to grant itself exclusive rights to the full suite of 30 programming networks under its control within the franchise areas of one or more of its cable clusters.[105] DIRECTV could in theory still distribute these Comcast/NBCU networks in other areas. But DIRECTV could no longer market those networks nationally—which, given its national operations, means that DIRECTV would have a difficult time marketing them at all. DIRECTV's customer service representatives might, for example, have to explain to irate subscribers in Washington, DC (served by Comcast) why they cannot receive USA Network when their neighbors in Fairfax County (served by Cox) can.[106] In the end, the value of the Comcast/NBCU networks to DIRECTV would be both dramatically lower on a per-subscriber basis *and* measured against a smaller potential subscriber base. In many such cases, DIRECTV might choose not to distribute such programming at all. Thus, the sunset of the exclusivity ban in one

[105] *See Notice*, Appendix B, Table 2 (listing networks).

[106] This example assumes that the "market" for purposes of this proposal would be the same "market" used for determinations of effective competition—namely a particular franchise area. The *Notice* seeks comment on how "market" should be defined for these circumstances. *Notice*, ¶ 70. As a national provider, DIRECTV has no views on the question as any alternative would be highly problematic. We would point out, however, that for competitive terrestrial providers, the question could be critical. If, for example, Comcast were permitted to obtain exclusive rights for "markets" covering its franchised areas, it is unclear what would happen with respect to a FiOS or U-Verse system that only partially overlapped a Comcast system. Would it enjoy program access protections for some, but not all, of its subscribers?

region would effectively become a sunset even in areas where the competition threshold established by the Commission has not been met.

Likewise, depending on how such market-by-market relief was formulated, not only would programmers affiliated with a cable operator *subject to competition* be allowed to offer exclusive programming, but programmers affiliated with *any* cable operator might also be able to do so. For instance, Comcast's programming networks might have the incentive to withhold programming from DIRECTV in markets where Cox has obtained a "license to exclude." The Commission has recognized that "a cable operator may gain by weakening a current or potential rival (such as a DBS operator) even in markets that the cable operator does not serve."[107] This would cause a separate set of problems.[108]

B. RSNs and Other "Must-Have" Programming

The *Notice* also seeks comment on whether to retain an exclusive contract prohibition only with respect to satellite-delivered, cable-affiliated RSNs and other

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[107] *2007 Extension Order*, ¶ 72.

[108] If the Commission nonetheless were to decide to use a "market share" determination, it could not borrow the metric used for the existing franchise-by-franchise determination of "effective competition," as that metric is designed solely for the purpose of triggering cable-rate deregulation. *See* 47 U.S.C. § 543(a)(2). Had Congress intended that test to be used to determine whether sunset of the exclusivity prohibition was warranted, it could easily have said so in the statute. *See KP Permanent Make-Up, Inc. v. Lasting Impression I, Inc.*, 543 U.S. 111, 118 (2004) ("Where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion" (internal brackets and quotations omitted)). Moreover, as a practical matter, that determination requires only that cable's competitors control a mere 15 percent of the market. *See* 47 U.S.C. § 543(l)(1)(B)(ii). That threshold is already met in most (if not all) DMAs, and is not nearly sufficient to counter a cable operator's incentive and ability to withhold key programming. *See 2007 Extension Order*, ¶ 59 (discussing analysis showing that withholding would be profitable when a single MSO passes 60 to 80 percent of homes in a DMA).

"must-have" or "marquee" programming.[109] In 2007, the Commission rejected calls to differentiate between categories of programming for purposes of this prohibition. It should do so again here.

Difficulty in Determining "Must-Have" Programming. As the Commission has found, it would be difficult to develop an objective process of general applicability to determine what programming may or may not be essential to preserve and protect competition.[110] To date, the Commission's analysis has focused on RSNs, and has repeatedly shown that withholding of RSN programming significantly degrades the ability of rival MVPDs to compete. Clearly, RSNs are a category of programming that would qualify as "must-have" by any measure.

But RSNs are not the only "must-have" programming. Evidence is readily available only with respect to RSNs for no other reason than that some RSNs are terrestrially delivered, and thus *could* be withheld, whereas the cable exclusivity prohibition effectively prevented case studies on the effect of withholding national programming. As the Commission has recognized, there is every reason to believe that the "lack of access to popular non-RSN networks would not have a materially different impact on a [competitor's] subscribership than would lack of access to an RSN."[111]

To take perhaps the most obvious example, national sports networks have many characteristics in common with regional ones. Both contain programing that is "non-replicable and valuable to consumers," and "no amount of investment can duplicate the unique attributes of such programming, and denial of access to such programming can

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[109] *Notice*, ¶ 72.

[110] *2007 Extension Order*, ¶ 69. *See also 2002 Extension Order*, ¶ 69 (same).

[111] *See 2007 Extension Order*, ¶ 39.

significantly hinder an MVPD from competing in the marketplace."[112] MVPDs would have a very difficult time competing without providing the wide array of professional and major college sports available on ESPN,[113] a fact reflected in the industry-leading carriage rates that network commands.

Even beyond sports, the Commission has recognized that "cable programming—be it news, drama, sports, music, or children's programming—is not akin to so many widgets."[114] Rather, all "cable programming is highly differentiated, so the foreclosed rivals cannot practically or inexpensively avoid the harm by substituting other programming."[115] For example, viewers devoted to the serial dramas on AMC (such as "Mad Men") would not see other channels, with different programs, as adequate substitutes.[116]

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[112] *AT&T HD Access Order*, ¶30 (*citing 2010 Program Access Order*, ¶ 9).

[113] ESPN's sports lineup for 2012 includes "NFL's *Monday Night Football*; MLB; NBA (The Finals on ABC); NASCAR, IndyCar and NHRA; college football and the BCS; men's and women's college basketball, including the women's NCAA Tournament; tennis' four Grand Slam events; golf's Masters, U.S. Open and British Open; FIFA World Cup; WNBA; Little League World Series; and more." *See* ESPN, Inc. Fact Sheet (*available at* http://espnmediazone.com/us/espn-inc-fact-sheet/).

[114] *2002 Extension Order*, ¶ 33. *See also id.* (finding that "there is a continuum of vertically integrated programming, ranging from services for which there may be substitutes (the absence of which from a rival MVPD's program lineup would have little impact), to those for which there are imperfect substitutes, to those for which there are no close substitutes at all (the absence of which from a rival MVPD's program lineup would have a substantial negative impact)").

[115] *Comcast/NBCU Order*, ¶ 37 n.90.

[116] *See 2002 Extension Order*, ¶ 69 (recognizing that certain programming services, "such as HBO, may be essential and for practical purposes, 'must haves' for program distributors and their subscribers"). Indeed, AMC's website now warns DISH Network subscribers that "YOU ARE ABOUT TO LOSE" Mad Men, and other series, and directs customers to other MVPDs that provide this key programming. AMC's DISH Dispute Website (*available at* http://www.keepamcnetworks.com/).

In sum, it would be difficult to determine, objectively and in advance, which programming is "must-have" and therefore worthy of continued protection. It is far better to "adhere to Congress's statutory design"[117] by recognizing that every network has a unique value to those who watch it, that the value of any particular network or group of networks can change very quickly, and that all programming should be protected.

Bundles of programming. Moreover, if the Commission were to attempt to define which programming is worthy of continued protection, focusing on individual networks would be the wrong exercise. As discussed above in Section I.B.2, it is not merely individual networks that are marquee programming. Combinations of networks can also be critical to MVPDs' ability to compete—and cable affiliated programmers such as Comcast are able to withhold as many as dozens of networks at a time. In a world of bundled programming, the Commission would have to consider how to evaluate exclusive arrangements that apply to a suite of programming rather than to an individual network.[118] This could make an already challenging line-drawing exercise more difficult still.

IV. EVEN IF AUGMENTED, OTHER SAFEGUARDS WOULD BE INSUFFICIENT TO PROTECT COMPETITION AND DIVERSITY IN THE ABSENCE OF THE EXCLUSIVE CONTRACT PROHIBITION

As discussed in the *Notice*, the exclusive content prohibition is one of several protections that Congress put in place to promote the efforts of MVPDs to compete in the

[117] *Cablevision I*, 597 F.3d at 1315.

[118] *See Comcast/NBCU Order*, Appendix B, ¶ 46 (stating that the relevant economic analysis "suggests that the overall bundle of NBCU cable networks is critical programming that MVPDs need to offer a competitive service that is attractive to consumers even if no individual network in the bundle were considered 'marquee' programming").

video distribution market against incumbent cable operators.[119] Unfortunately, however, removing part or all of the exclusive content prohibition from this carefully woven web of safeguards would render the remaining provisions insufficient to adequately preserve and protect competition and diversity in the video distribution market.

Each of the possible alternatives to the exclusivity prohibition would force the Commission and competitive MVPDs to rely upon an expensive and lengthy case-by-case determination in which the complainant would bear the burden. This is the exact opposite of today's regime in which cable exclusives are prohibited unless the cable operator or affiliated programmer can demonstrate that the public interest is to the contrary. Given the ongoing need for protection of competition and diversity, and Professor Murphy's observation that cable-affiliated programmers have the incentive to withhold *precisely* where doing so would cause price increases and competitive harm, reversing the status quo would not be sufficient to protect competition and diversity. Accordingly, the Commission should confirm the determination it made in the *2002 Extension Order*: "We do not believe other provisions in the statute . . . are adequate substitutes for the particularized protection afforded under Section 628(c)(2)(D)."[120]

Below, we discuss each of these alternate provisions—Section 628(b)'s prohibition against anticompetitive acts, Section 628(c)(2)(A)'s prohibition against discrimination, and Section 628(c)(2)(B)'s prohibition against undue influence—and explain why they are not adequate substitutes. The Commission has also asked about

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119 *Notice*, ¶ 47.

120 *Id. See also Time Warner Entm't Co. v. United States*, 211 F.3d 1313, 1322-23 (D.C. Cir. 2000) ("a prophylactic, structural limitation is not rendered unnecessary merely because preexisting statutes impose behavioral norms and *ex post* remedies").

potential modifications of these provisions. DIRECTV believes such modifications would be useful. They would become even more important were the Commission to fully or partially sunset the exclusivity prohibition—but would not in and of themselves enable the respective provisions to replace the exclusivity provision.

A. Section 628(b)'s General Prohibition Against Anticompetitive Acts

Section 628(b) is a catch-all provision designed to capture a wide range of potential anticompetitive acts. As implemented by Section 76.1001(a) of the Commission's rules, this provision creates a right of action if an MVPD can demonstrate that a cable operator or cable-affiliated programmer has engaged in an unfair act, the purpose or effect of which is to significantly hinder or prevent the MVPD from providing programming to consumers.[121]

Inadequacy as Substitute for Exclusivity Prohibition. Unlike the exclusive contract prohibition, this provision places the burden squarely on the complaining MVPD to demonstrate harm to competition, in the form of an unfair act that must be shown to have a specified purpose or effect. This is no small burden, as demonstrated by the two most recent cases brought under Section 628(b), each of which "lasted over two years and involved over a thousand pages of pleadings and studies, extensive discovery, multiple rounds of briefings, and multiple conferences with the parties."[122]

As discussed at length above, given the demonstrable harm caused by cable-affiliated exclusives, it would be counterproductive to require MVPDs to go through such

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[121] 47 U.S.C. § 548(b); 47 C.F.R. § 76.1001(a). This statutory provision does not include a sunset provision.

[122] *Verizon HD Access Review Order*, ¶ 4. *See also AT&T HD Access Review Order*, ¶ 4 (same).

lengths to address this harm.[123] Doing so would result in at least some anticompetitive exclusive arrangements going unchallenged simply because of the cost, time, and effort associated with prosecuting a program access complaint. While this would be problematic for DIRECTV, it would be even more of a barrier for smaller MVPDs, who very likely would find themselves unable to afford vindication of their rights against large, well-funded MSOs.

Presumption of Harm for Key Programming. While Section 628(b) is not an adequate replacement for the cable exclusivity prohibition in Section 628(c), the Commission could better adapt it to this purpose by adopting the same rebuttable presumption of "significant hindrance" for exclusive contracts involving satellite-delivered, cable-affiliated RSNs that already applies with respect to unfair acts involving terrestrially-delivered, cable-affiliated RSNs.[124] This would be appropriate because cable's "incentive and ability do not vary based on whether the cable-affiliated programming is delivered to cable operators by satellite or by terrestrial means."[125] Moreover, as described above, national sports networks share many of the same qualities as regional ones, and other "marquee" programming can have a similar competitive effect.[126] Therefore, the Commission should consider extending this presumption to national sports and other "marquee" networks as well. As the Commission recognized in the *2010 Program Access Order*, requiring each competitive MVPD to make an individualized showing of harm could necessitate a large number of largely redundant

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[123] *See* Sections I-II, above.

[124] *Notice*, ¶¶ 53-54.

[125] *2010 Program Access Order*, ¶ 26.

[126] *See* Section II.B.2, above.

proceedings.[127] A presumption would at least obviate the need for such duplicative efforts.

Presumption of Harm for Particular Network Where Violation Has Already Been Found. In addition, once a complainant succeeds in demonstrating that an exclusive contract involving a satellite-delivered, cable-affiliated programming network violates Section 628(b), any other exclusive contract involving the same network should be held to violate that provision as well.[128] This second presumption appears compelled by the statute—which requires that the "purpose or effect" of a particular unfair act is to "significantly hinder or prevent *any* [MVPD] from providing satellite cable programming or satellite broadcast programming to subscribers or consumers."[129] Once that harm is demonstrated with respect to "any" MVPD, the demonstration is unnecessary for other MVPDs.

The Commission should adopt these presumptions regardless of what it ultimately decides with respect to the exclusivity prohibition. It should also harmonize the procedural rules and policies for a complaint under Section 628(b) whether the programming at issue is delivered by satellite or by terrestrial means.[130]

B. Section 628(c)(2)(B)'s Prohibition on Discrimination

The Commission describes the prohibition on discrimination in Section 628(c)(2)(B) as another potential avenue for redress in the absence of the exclusive

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127 *Notice*, ¶ 55.

128 *Id.*, ¶ 56.

129 47 U.S.C. § 548(b); 47 C.F.R. § 76.1001(a).

130 *Notice*, ¶ 51. This would include the policy of examining the availability of HD programming separately from SD programming. *Id.*, ¶ 54.

contract prohibition.[131] As with the generalized "unfair practices" provision, this is something of a mixed bag as a potential substitute for the exclusivity prohibition.

Inadequacy as Substitute for Exclusivity Ban. Even with clarifications proposed by the Commission, the antidiscrimination provision is no substitute for the exclusive contract prohibition. As the Commission concluded five years ago, a non-price discrimination complaint requires an MVPD to demonstrate that the conduct was "unreasonable," which "can be difficult to establish."[132] From DIRECTV's perspective, the most "difficult" part of making such demonstrations is the cost and effort required to do so in individual cases, not the determination of whether the discrimination it encounters is in fact "unreasonable." Here again, the two-year *AT&T* and *Verizon* proceedings, described above, are instructive.[133] Determining the "reasonableness" or "unreasonableness" of any particular exclusive arrangement would be a highly factual, highly document-intensive, and very lengthy process. And here again, if the Commission concludes based on the evidence in this proceeding that the exclusive arrangements cable-affiliated programmers would engage in are nearly always harmful, it should not then require complainant MVPDs to undertake such efforts in pursuit of a largely preordained outcome.

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131 *See* 47 U.S.C. § 548(c)(2)(B).

132 *See 2002 Extension Order*, 17 FCC Rcd at 12153-54, ¶ 65 n.206 ("We do not believe other provisions in the statute—namely, Sections 628(b), 628(c)(2)(A), and 628(c)(2)(B)–are adequate substitutes for the particularized protection afforded under Section 628(c)(2)(D)."); *2007 Extension Order*, 22 FCC Rcd at 17796-97, ¶ 6 and 17834-35, ¶ 62 n.320 (same).

133 *See Verizon HD Access Review Order*, ¶ 4 (noting that the proceeding had "lasted over two years and involved over a thousand pages of pleadings and studies, extensive discovery, multiple rounds of briefings, and multiple conferences with the parties"); *AT&T HD Access Review Order*, ¶ 4 (2011) (same).

Exclusive Contracts. Regardless of how it rules on the exclusivity prohibition, the Commission should conclude that the nondiscrimination provision actually covers exclusive contracts. As the *Notice* points out, the Commission has held that non-price discrimination includes an unreasonable refusal to license programming to an MVPD.[134] The *Notice* then draws a possible distinction between so-called unilateral exclusive arrangements (in which, for example, a cable-affiliated programmer happens to sell only to its cable affiliate) and exclusive bilateral contracts (under which, for example, the two entities have reduced the arrangement to writing).[135]

The Commission lays out a statutory argument in favor of treating the two situations similarly.[136] Section 628(c)(2)(B)(iv) provides that it is not a violation for a satellite-delivered, cable-affiliated programmer to "enter[] into an exclusive contract that is permitted under [Section 628(c)(2)(D)]."[137] This has been interpreted to pertain to only those exclusive contracts that have been deemed by the Commission to be in the public interest,[138] but the *Notice* asks whether it should also apply to exclusive contracts

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[134] *See Notice*, ¶ 58 (*citing Implementation of Sections 12 and 19 of the Cable Television Consumer Protection and Competition Act of 1992: Development of Competition and Diversity in Video Programming Distribution and Carriage*, First Report and Order, 8 FCC Rcd. 3359 ¶¶ 14, 116 (1993) ("*1993 Program Access Order*")).

[135] *Notice*, ¶¶ 60-61.

[136] The Commission also notes that the decision of a satellite-delivered, cable-affiliated programmer to license its programming to a DBS operator but not to other MVPDs could be challenged as an unreasonable refusal to deal pursuant to Section 628(c)(2)(B). *See Notice*, ¶ 61 and n.209 (citing cases). Were this provision not to apply to decisions to selectively license to cable operators only, the result would be "anomalous" at best. *Id.*

[137] 47 U.S.C. § 548(c)(2)(B)(iv).

[138] *See* 47 U.S.C. § 548(c)(2)(D) (prohibiting specified exclusive contracts "unless the Commission determines (in accordance with [Section 628(c)(4)]) that such contract is in the public interest"); *Implementation of Section 302 of the Telecommunications Act of 1996, Open Video Systems*, Second Report and Order, 11 FCC Rcd. 18223, ¶ 185 n.428 (1996) ("We interpret this provision as providing a safe harbor from challenge under Section

permissible under a sunset.[139] The key point is not so much that it should apply after sunset (although it should) as that it can apply to exclusive contracts generally. So long as an exclusive contract is not "permitted" under the cable exclusivity prohibition, it is also governed by the non-discrimination provision.[140]

Even setting statutory arguments aside, attempting to draw a distinction between unilateral arrangements and bilateral contracts would be unworkable in practice. Particularly where exclusive arrangements occur between affiliates (such as, for example, Comcast SportsNet Philadelphia and Comcast's cable systems), such distinctions are meaningless. There is no such thing as a "unilateral arrangement" among companies under common control.

Exclusive Arrangements. It is even clearer that the Commission's antidiscrimination rules apply to cable-only exclusive arrangements. As described above in Section I.B.2, such an arrangement allows a cable-affiliated programmer to sell its programming to non-overlapping incumbent cable systems (thereby minimizing its lost distribution) but refuse to sell to competing MVPDs. As the Commission put it:

628(c)(2)(B)'s discrimination prohibition to exclusive contracts that the Commission has determined to be in the public interest under Section 628(c)(2)(D).").

139 *See* 47 U.S.C. § 548(c)(5).

140 That section 628(c)(2)(B) does not require a showing of harm but does include a "legitimate business reason" defense for otherwise discriminatory treatment does not change this conclusion. *Notice*, ¶ 62. The "legitimate business reason" defense is a necessary component of any antidiscrimination provision—it is simply another way of saying that treating differently situated MVPDs differently is not in fact discrimination. If one has a legitimate business reason to refuse to sell programming to one MVPD but not another, the two are not similarly situated. *See* Giovanna Shay, "Similarly Situated," 18 GEO MASON L. REV. 581, 583 (2011) (describing origins of term in equal protection jurisprudence). Indeed, on the whole this formulation is more favorable to a respondent than the exclusivity provision, which (as the Commission notes) assumes harm but permits a cable-affiliated programmer to make a showing that such harm does not exist. It makes perfect sense that Congress would create a more categorical regulation (such as the exclusivity prohibition) with a sunset, while leaving a less categorical regulation (such as the antidiscrimination provision) without one.

> [O]ur rules and precedent establish that the discrimination provision in Section 628(c)(2)(B) would prevent a satellite-delivered, cable-affiliated programmer from licensing its content to MVPD A (such as a DBS operator) in a given market area, but to selectively refuse to license the content to MVPD B (such as a telco video provider) in the same area, absent a legitimate business reason.[141]

There is no reason why this should not apply where "MVPD A" is "all cable operators" and "MVPD B" is "all satellite carriers."

This commonsense conclusion would take on more importance were the Commission to fully or partially sunset its exclusivity prohibition. Given the increasing level of coordination among the nation's largest cable MSOs,[142] it is reasonable to expect that coordinated cable-only exclusivity would arise were the cable exclusivity prohibition allowed to sunset.

C. Section 628(c)(2)(A)'s Prohibition Against Improper Influence

Section 628(c)(2)(A) prohibits cable operators from unduly or improperly influencing the decision of an affiliated programmer to sell, or the prices, terms, and conditions of sale of, programming to any unaffiliated MVPD.[143] This, like the provisions discussed above, is of questionable utility in replacing the exclusivity prohibition.

The Commission has long recognized that the concept of undue influence between affiliated firms is closely linked with discriminatory practices and exclusive

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[141] *Notice*, ¶ 64 (*citing 2007 Extension Order*, ¶ 60 n.309 ("[A] vertically integrated programmer that withholds programming from a recent entrant with a minimal subscriber base but chooses to offer the programming to all other competitive MVPDs in the market could be found in violation of the program access rules based on an unreasonable refusal to sell.")).

[142] *See* Section I.B.1, above.

[143] *See* 47 U.S.C. § 548(c)(2)(A).

contracting. The latter two are directly regulated pursuant to Sections 628(c)(2)(B), (C), and (D), based on externally ascertainable pricing and contracting information.

Accordingly, the Commission envisioned that Section 628(c)(2)(A) would "play a supporting role where information is available (such as might come from an internal 'whistleblower') that evidences 'undue influence' between affiliated firms to initiate or maintain anticompetitive discriminatory pricing, contracting, or product withholding."[144] It also found that "such conduct may be difficult for the Commission or complainants to establish."[145] It thus concluded that, other than in the relatively rare case in which information about undue influence becomes public, the prohibition on undue influence would be insufficient to prevent the anticompetitive effects of exclusionary conduct by cable-affiliated programmers.[146]

Nothing has changed in the last five years to disturb these conclusions. Should the Commission sunset the exclusivity prohibition and modify the remaining provisions of Section 628 as discussed above, the provision on undue influence will—and must—retain its "supporting role." But it cannot be relied on alone, or even with the other provisions of Section 628, to take the place of the exclusivity prohibition.

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The Commission has previously found that each of these provisions is not an adequate substitute for the exclusivity prohibition. It should not change that determination here. The Commission's proposed modifications to those other provisions would certainly be useful—particularly adopting a rebuttable presumption with respect to

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144 *1993 Program Access Order*, ¶ 145.

145 *Id.*

146 *Id.*

RSN programming delivered via satellite, extending that presumption to other marquee programming, and concluding that the nondiscrimination provision actually covers exclusive contracts. But those modifications are best suited to enhance the cable exclusivity prohibition. They are not sufficient to render these provisions a substitute to the current regime.

V. THE COMMISSION SHOULD HARMONIZE THE *LIBERTY MEDIA ORDER* MERGER CONDITIONS WITH ANY ACTION TAKEN IN THIS PROCEEDING

Since Liberty Media acquired *de facto* control of DIRECTV in 2008 (which it has since relinquished), DIRECTV has operated pursuant to merger conditions under which its ability to enter into certain exclusive distribution arrangements is limited.[147] Because these conditions apply to both national and regional services and do not expire after the passage of a certain period of time, the *Notice* sought comment on whether and how to modify these conditions to conform to any revisions adopted for the cable exclusivity prohibition.[148] For the reasons discussed above, DIRECTV believes that the exclusivity prohibition should be extended in its entirety, in which case no modification of these conditions would be necessary.

If, however, the Commission were to allow the provision to sunset (in whole or in part), conforming modifications would be appropriate. For example, if the Commission were to retain the prohibition only with respect to RSNs and other "must have" programming, the exclusivity conditions on DIRECTV should apply only with respect to such programming. Similarly, if the Commission were to establish a procedure under

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[147] *News Corp., The DIRECTV Group, Inc., and Liberty Media Corp.*, 23 FCC Rcd. 3265, Appendix B, § III (2008).

[148] *See Notice*, ¶ 95.

which a cable operator or cable-affiliated programmer could seek to remove the prohibition on a market-by-market basis, the conditions on DIRECTV should be modified to permit exclusive contracts in any market subject to a successful petition. If the prohibition were allowed to sunset in its entirety, then the exclusivity prohibition in the conditions on DIRECTV should similarly be eliminated in its entirety.

Again, DIRECTV does not believe that a sunset of the exclusivity prohibition (in whole or in part) is warranted under current market conditions. It takes this position despite the fact that such a sunset should result in relief from the conditions imposed in 2008. The fact that DIRECTV stands to benefit from a sunsetting of the rule yet still feels strongly that it should be extended demonstrates how important cable-affiliated programming remains for successful competition in the MVPD market.

CONCLUSION

For the foregoing reasons, the Commission should extend the cable exclusivity ban contained in Section 628(c)(2)(D) in its entirety for another five years.

Respectfully submitted,

/s/

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June 22, 2012

EXHIBIT A

REPORT OF PROFESSOR KEVIN M. MURPHY

June 22, 2012

I have been asked by DIRECTV to review and comment on the Notice of Proposed Rulemaking ("*Notice*") released by the Federal Communications Commission ("Commission") on March 20, 2012. In the *Notice*, the Commission sought comments on, among other issues, whether to "retain, sunset, or relax….the prohibition on exclusive contracts involving satellite-delivered cable-affiliated programming" (the "cable exclusivity prohibition").[1] In this report, I comment on several economic factors that I believe the Commission should take into account in deciding the future of the cable exclusivity prohibition. To summarize:

1. Congress and the Commission are concerned that cable-affiliated program suppliers can use exclusive arrangements to harm competition. One way to test this theory is to determine whether non-integrated suppliers commonly use exclusives.
2. Evidence shows that the use of exclusives by non-integrated program suppliers is rare, while use of exclusives by cable-affiliated suppliers is more common when it is permitted. Since non-integrated suppliers are free to enter into exclusive arrangements with cable companies or other multichannel video programming distributors ("MVPDs"), economic theory predicts that non-integrated suppliers would use exclusives if they are efficient. The fact that they rarely do so suggests that such arrangements rarely are efficient.
3. The rarity of exclusive distribution agreements, either through contract or ownership (for non-cable MVPDs), is not surprising. It is consistent with economic theory and evidence. In particular, the types of services provided by MVPDs do not fit common efficiency theories of exclusives, so those theories do not predict that exclusives between program suppliers and MVPDs would be common. In addition, the types of programs that have been chosen for exclusives to date (Regional Sports Networks ("RSNs") in particular) also do not fit efficiency-driven theories of exclusivity.

[1] *Revision of the Commission's Program Access Rules,* 27 FCC Rcd. 3413, at ¶ 1 (2012) ("*Notice*").

4. The use of exclusives by vertically integrated suppliers also is not expected from efficiency-driven theories of exclusivity. Although there may be benefits to an MVPD from vertical integration into programming (such as the elimination of double-marginalization), these types of efficiencies can be achieved without exclusivity.[2]

5. Under widely accepted economic explanations for exclusives (such as internalizing free-riding and providing promotional and investment incentives), vertically integrated suppliers would have less need for exclusives than would non-integrated firms. Vertical integration substitutes for exclusivity as a way to align supplier and distributor incentives. The fact that cable-affiliated suppliers are more likely than non-integrated suppliers to use exclusives when they are allowed to do so (such as through the terrestrial loophole) implies that cable-affiliated suppliers must be responding to other incentives.

6. Employing an economic model that builds on the framework I used (and the Commission adopted) in the *Comcast-NBCU* proceeding, I find that, without the cable exclusivity prohibition, vertically integrated cable companies would find it profitable in certain circumstances to withhold some programming from competitors. Moreover, vertically integrated suppliers would find it in their interest to withhold programming *precisely when withholding has the worst price impacts for consumers*: that is, when making it available means (1) the price charged consumers by the vertically integrated MVPD would fall the most and (2) its competitors' prices would increase the least.

7. Available empirical evidence suggests that, when given access to programming previously not available to them, competing MVPDs take the majority of their resulting gains in the form of subscriber growth rather than higher prices.

[2] Indeed, under the most common framework used to evaluate the incentive effects of vertical integration between content suppliers and MVPDs, the incentive effects that generate procompetitive benefits from vertical integration also generate incentives to raise prices and/or deny content to rivals.

I conclude that, absent a contrary showing by vertically integrated cable companies or others, economic theory and empirical evidence suggest that there would be little if any loss of efficiency from continuing the cable exclusivity prohibition. However, continuation could provide non-cable MVPDs with important programming that they otherwise would lose, and could benefit consumers by preventing withholding in those cases where program access would have the largest competitive benefits.

I. Background on the Proceeding and the Exclusivity Rules

As part of the Cable Television Consumer Protection and Competition Act of 1992, Congress adopted program access provisions to address the "imbalance of power, both between cable operators and program vendors and between incumbent cable operators and their multichannel competitors" that resulted in "the development of competition among MVPDs [being] limited and consumer choice [being] restricted."[3] According to the *Notice*, the "program access provisions afforded several protections to MVPDs in their efforts to compete in the video distribution market."[4]

In 1992, when the program access provisions were adopted, DBS was just emerging as a competitor, there were no strong wireline (telco) MVPDs, and local cable operators were the dominant suppliers of MVPD services. But MVPD competition has changed since 1992. The two national DBS competitors that began operations in the mid-1990s now reach homes throughout the entire United States, and two important telco MVPDs operate in many local areas. The FCC has taken such increased MVPD competition into consideration in its periodic review (first in 2002 and then in 2007) of whether to extend the cable exclusivity prohibition. Both times it decided to do so, concluding that the prohibition remained "necessary."[5]

The program access rules have several elements, and impose restrictions on firms that both supply programming and own cable systems ("vertically integrated cable firms").[6] One

[3] *Notice,* ¶6.
[4] *Notice,* ¶7.
[5] *Notice,* ¶12. Certain cable MVPDs appealed the Commission's 2007 decision, but the D.C. Circuit Court affirmed. *Notice,* ¶16.
[6] As a condition of FCC approval of its acquisition by News Corp. and Liberty Media, DIRECTV also is prohibited from refusing to license programming it owns or controls to other MVPDs. *News Corp. and the DIRECTV Group,*

element is a general prohibition on exclusive contracts between a cable operator and a cable-affiliated programmer. A vertically integrated cable firm cannot restrict the supply of its programming to only its own or another cable system, but also must offer that programming (on nondiscriminatory terms) to other MVPDs, including those against which it competes.[7] Vertically integrated cable firms can apply to the FCC for exemptions to the exclusivity prohibition,[8] but only two such exemptions have been granted (for two local news networks) since the enactment of the 1992 Act twenty years ago.[9]

The rules also prohibit discriminatory pricing by vertically integrated cable firms of the programming that they supply. This element prevents firms from charging different prices to MVPDs that do and do not compete with them directly. Other provisions implement the Cable Act's prohibition on "unfair methods of competition" and "undue influence" on the prices that the programming division of a vertically integrated firm charges other MVPDs.[10]

As it did in 2002 and 2007, the Commission now must consider whether to extend or amend the cable exclusivity prohibition. The Commission will consider the current state of competition in video distribution and programming, as well as economic theory and its own

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Inc., Transferors, to Liberty Media Corp., Transferee, 23 FCC Rcd. 3265, Appendix B, § III (2008) ("*Liberty Media Order*").

[7] Until recently, this prohibition applied only to satellite-delivered programming, not to programming delivered terrestrially. This allowed some cable systems to refuse to offer terrestrially delivered RSNs to MVPD competitors. This "loophole" was closed in 2010. (*Review of the Commission's Program Access Rules and Examination of Program Tying Arrangements*, 25 FCC Rcd. 746, ¶ 1 (2010) ("*2010 Program Access Order*").) *See also* Press Release, *FCC Issues Order Promoting Competition In The Video Distribution Market* (Jan. 20, 2010), *available at* http://hraunfoss fcc.gov/edocs_public/attachmatch/DOC-295842A1.pdf ("The Order concludes the Commission has authority under Section 628(b) of the Communications Act to take action if a cable operator engages in unfair acts with respect to terrestrially delivered, cable affiliated programming that significantly hinder a multichannel video programming distributor from providing satellite cable programming to consumers").

[8] *Notice,* ¶8 ("An exclusive contract is permissible if the Commission determines that it is 'in the public interest'").

[9] *Id.*

[10] *Notice,* ¶7 ("Sections 628(b), 628(c)(1), and 628(d) of the Act grant the Commission broad authority to prohibit 'unfair acts' of cable operators, satellite cable programming vendors in which a cable operator has an attributable interest, and satellite broadcast programming vendors that have the 'purpose or effect' of 'hinder[ing] significantly or prevent[ing]' any MVPD from providing 'satellite cable programming or satellite broadcast programming to subscribers or consumers'"); ¶67 ("Section 628(c)(2)(A) precludes a cable operator that has an attributable interest in a satellite cable programming vendor or a satellite broadcast programming vendor from 'unduly or improperly influencing the decision of such vendor to sell, or the prices, terms, and conditions of sale of, satellite cable programming or satellite broadcast programming to any unaffiliated [MVPD]'").

predictive judgment.[11] If past proceedings in which the Commission considered sunsetting the cable exclusivity prohibition are prologue, I would expect some vertically integrated cable MVPDs to argue that there no longer is a need (if indeed there ever was) for the prohibition or for program access rules more generally, and that an extension will create inefficiencies and possibly weaken competition. The Commission's task, as it explained in the *Notice*, is to evaluate such claims in light of all the evidence it has available, and then to decide whether the rules continue to be necessary to preserve and protect competition and diversity in the distribution of video programming, or whether they are "excessively burdensome."[12]

II. Changes in the Industry

The Commission noted in the *Notice* that it considered several types of evidence during previous proceedings on extending the cable exclusivity prohibition, including the number of MVPD subscribers nationwide and in particular local markets, national and local market shares by type of MVPD (e.g., cable market share), and the number of national and regional programming networks and the percentage of these networks that are cable-affiliated.[13] The *Notice* provides recent data that show that the number and share of MVPD subscribers attributable to cable operators has declined nationally since 2007, while the number of DBS subscribers has increased since that time.[14]

However, changes since 2007 in the number and shares of subscribers to individual MVPDs and types of MVPDs is not sufficient evidence of how competition has changed since 2007 and is likely to evolve in the future. Changes in the marketplace during the recent past and

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[11] The Commission noted that it considered these factors in 2007. Notice, ¶13 ("[I]n considering the applicable standard of review, the Commission determined that it may use its predictive judgment, economic theory, and specific factual evidence in determining whether, 'in the absence of the prohibition, competition and diversity in the distribution of video programming would not be preserved and protected'" (footnote omitted)). It also noted that some of the relevant factual evidence is other conditions imposed in the past. For example, in its approval of the Comcast/NBCU transaction, the Commission imposed a requirement for baseball-style arbitration "that allows an aggrieved MVPD to submit a dispute with Comcast-NBCU over the terms and conditions of carriage of programming to commercial arbitration." *Notice,* ¶20. Other "protections that the program access rules afford to competitive MVPDs in their efforts to compete in the video distribution market" include rules for filing complaints over alleged "unfair acts" that hinder the MVPDs ability to provide programming and filing price and non-price discrimination complaints. *Notice,* ¶¶26-67.

[12] *Notice,* ¶1.

[13] *Notice,* ¶22.

[14] *Notice*, Appendix A.

anticipated changes in the near future likely have a mixed effect on the degree of competition that local cable MVPDs face, and the balance of these effects is unlikely to be uniform across local markets.

An important change in the market since 2007 has been the entry of wireline-based MVPDs (most prominently, AT&T with U-verse and Verizon with FiOS) into many geographic areas. In part, the decline in the national market share of cable MVPDs and in their share in some DMAs reflects this telco entry. However, telco entry has not occurred in all DMAs, and telco MVPD service within a DMA typically is available only to some households.[15]

While cable MVPDs now face an additional competitor in areas served by telco MVPDs that they did not face in 2007, the pace of telco entry into local markets has slowed. "AT&T and Verizon pulled back on video expansion" in the first quarter of 2012,[16] and AT&T has decided "to halt an expansion of the U-verse footprint."[17] Thus, telco expansion has declined, telco MVPDs have not entered many areas, and Verizon and AT&T have announced that they do not plan much if any further expansion.[18]

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[15] *See Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 26 FCC Rcd 14091, ¶ 2 & n.8 (2011) (noting that Verizon reported 3.5 million FiOS customers and AT&T reported nearly 3 million U-Verse customers); *see also* Verizon FiOS Fact Sheet, http://newscenter.verizon.com/kit/fios-symmetrical-internet-service/all-about-fios html (noting that as of the end of 2011 FiOS is available in 12 states and the District of Columbia and 15.8 million premises are passed by the FiOS network), Press Release, *Best-Ever Mobile Broadband Sales and Strong Cash Flows Highlight AT&T's Fourth-Quarter Results; Stock Buyback Begins on Previous 300 Million Share Authorization*, Jan. 26, 2012, http://www.att.com/gen/press-room?pid=22304&cdvn=news&newsarticleid=33762 (noting AT&T U-verse passes 30 million living units. For the 20 DMAs in which FiOS is offered and the 65 DMAs in which U-Verse is offered, only about 40% of homes in those DMAs are passed by the provider. Centris National Tracking Study, April 2012.

[16] SNL Kagan, *Video growth enjoys seasonal lift in Q1; service providers notch sub gains*, May 16, 2012, *available at* http://www.snl.com/InteractiveX/article.aspx?id=14904936&KPLT=2.

[17] *Id.*

[18] *AT&T's CEO Discusses Q4 2011 Results – Earnings Call Transcript*, Seeking Alpha (Jan. 26, 2012), http://seekingalpha.com/article/322378-at-t-s-ceo-discusses-q4-2011-results-earnings-call-transcript?part=qanda ("[W]e've got the U-verse build complete or essentially complete. We will continue to do a little bit more here and there, but we've past 30 million homes, so now we have a full 30 million home capability to sell into"). *See also*, Cecilia Kang, *Verizon ends satellite deal, FiOS expansion as it partners with cable*, WASH POST, Dec. 8, 2011; ("Verizon Chief Executive Lowell McAdam said the telecom giant … will stop its buildout of FiOS television and Internet services in the next couple years"); AT&T Inc., Annual Report (Form 10-K), at 2 (Feb. 24, 2012) ("As of December 31, 2011, we reached our deployment goal of 30 million living units and have now passed 30.3 million living units (constructed housing units as well as platted housing lots). We are marketing U-verse services to 78% of those units and had 3.8 million subscribers by year-end 2011. During 2012, we will continue our efforts to increase sales to this base"); Verizon, Inc., Annual Report (Form 10-K), at 8 (Feb. 24, 2012) ("As of December 31, 2011, FiOS Video is available to approximately 13 million homes across 12 states, as well as the District of Columbia").

A second important change in the MVPD industry is the growth of bundled offerings (e.g., "triple plays") of video, high speed Internet, and phone service by cable and telco MVPDs.[19] This and related technological advances that have provided cable MVPDs more, and more flexible, capacity (such as DOCSIS 3.0) give cable MVPDs a competitive advantage over the DBS MVPDs.[20] DBS firms have marketed "synthetic" bundles that combine video services with other companies' Internet and phone service, but these bundles have had limited commercial success and have become even less viable in areas where potential contributors to a DBS bundle (for example, digital subscriber line services from Verizon or AT&T) now market their own video services and "triple plays" and so view DBS as a direct competitor,[21] and where cable has rolled out DOCSIS 3.0.

The importance of the triple play may be reflected in the fact that, in areas where there is no telco competition, cable's share of total TV households has declined much more slowly since the last Commission review in 2007. Between 2007 and 2011, cable MVPDs' share of pay TV households declined by 11.4 percent in areas where wireline-based competitors entered, compared with a decline of only 4.3 percent in areas where they did not. The corresponding changes since 2008 are 9.6 percent and 1.5 percent.[22]

The Commission concluded in 2007 that, "even with [substantial] developments in the programming and distribution markets, the concerns upon which Congress based the program access provisions persist in the marketplace, and thus we find the exclusive contract prohibition continues to be necessary to preserve and protect competition and diversity in the distribution of

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[19] See, e.g., SNL Kagan, *Video growth enjoys seasonal lift in Q1; service providers notch sub gains*, May 16, 2012 ("Approximately 68% of FiOS video customers are opting in for triple-play packages").
[20] Comcast Corporation, 2011 Annual Review Letter to Shareholders, at 1 (Apr. 20, 2012) ("Key to our strong operating performance has been our technological leadership in cable. With the major platform initiatives of DOCSIS 3.0, All Digital, and our Content Delivery Network now complete, we are leveraging these investments to deliver better products and more innovation, faster than ever before"); Time Warner Cable Inc., Annual Report (Form 10-K), at 4 (Feb. 27, 2012) ("Utilizing DOCSIS 3.0 technology, TWC offers Wideband and Extreme to subscribers in the majority of its service areas"); Charter Communications, Inc., Annual Report (Form 10-K), at 6 (February 27, 2012) ("We completed the roll out of DOCSIS 3.0 to 93% of our homes passed in 2011").
[21] Trefis Team, *Dish Can't Compete With Telcos But Stock Can Glide To $26*, FORBES Nov. 3, 2010) ("DBS operators don't offer phone service and have tied up with telcos like AT&T in the past to create synthetic bundles… However, synthetic bundles have not been very effective. Further, as telcos continue with the planned roll-out of their video services, they have been weaning away satellite customers, more worryingly, from synthetic bundle households").
[22] Annual changes are calculated based on data for the first quarter of each year. Telco entry in each DMA was measured based on subscription data for first quarter, 2011. Centris National Tracking Study, 2007q1-2011q1.

video programming,"[23] and it concluded in 2010 that "cable firms withhold affiliated programming from competitors when not barred from doing so"[24] these concerns may still apply given limitations on the ability of DBS firms to compete with the bundles of services that consumers increasingly prefer, and the strategic (and perhaps commercial) limitation on expansion of telco MVPDs. In particular, DBS firms' current national market shares likely overstate their role in providing a competitive constraint on cable MVPDs in the future, both in general and in particular local markets. In markets without competition from wireline-based MVPDs, there has not been any entry of substantial new suppliers to offset the impact of the increased advantage cable suppliers have gained from improved technologies (such as DOCSIS 3.0) and the growing importance of the triple-play.

III. Exclusive Programming Arrangements are Rare

A common method that economists use to evaluate whether contracting and other business practices enhance efficiency is to see if they are widely used. Practices that are widely used in contexts where market power is not a concern are generally presumed to have efficiency benefits. Practices that are not used or are used very infrequently in such contexts likely do not enhance efficiency.

This empirical framework can help determine the potential for exclusivity in program licensing to enhance efficiency, and thus how efficiency might be affected by the cable exclusivity prohibition. The program access rules prohibit one type of exclusive arrangement – between a cable MVPD and cable-affiliated programmers.[25] However, the rules and Commission policy generally leave marketplace participants free to negotiate other exclusive

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[23] *Implementation of the Cable Television Consumer Protection and Competition Act of 1992 – Development of Competition and Diversity in Video Programming Distribution: Sunset of Exclusive Contract Prohibition*, 22 FCC Rcd. 17791, ¶ 16 (2007) ("*2007 Extension Order*"), *aff'd sub nom. Cablevision Sys. Corp. v. FCC*, 597 F.3d 1306 (D.C. Cir. 2010) ("*Cablevision I*").

[24] *2010 Program Access Order*, ¶ 30.

[25] I note that cable operators and cable-affiliated programmers have the right under the Communications Act to petition the Commission for authority to enter into exclusive arrangements that would serve the public interest, yet only 10 such petitions have ever been filed, and none in the last 15 years (*Notice,* ¶*8,* n. 28). *See also* Brief for Petitioners at 50, *Cablevision Sys. Corp. v. FCC* , 2008 WL 6201083 at 10 (C.A.D.C., filed Oct. 8, 2008)) ("The current rules do not prohibit cable operators from entering into exclusive agreements with the many video-programming services that are not affiliated with any cable operator. Yet, there have been few instances in which such agreements occurred").

arrangements that could prevent competing and other MVPDs from licensing attractive programming. In particular:

- Cable MVPDs can negotiate exclusive licenses with unaffiliated programmers;
- DBS and telco firms can negotiate exclusive licenses with unaffiliated programmers;
- DISH and telco firms are free to refuse to license affiliated programming.[26]

Examining the use of exclusivity by MVPDs and programmers that are free to engage in exclusive programming arrangements provides considerable insight into the economic reasons for and the likely impact of the behavior of their vertically-integrated cable counterparts.

There appear to be very few examples of voluntarily negotiated exclusive agreements involving non-integrated program suppliers. (NFL Sunday Ticket is an important exception, and I explain later in my report why economic theory and the specifics of that arrangement are consistent with the very limited efficiency benefit from exclusive arrangements generally).

The examples of exclusive agreements I have seen almost always involve cable-affiliated programming suppliers. Of those, the most important networks (in terms of revenue and viewership) that have been withheld from a competitor are terrestrially delivered RSNs.[27] Until 2010, cable MVPDs could refuse to license these networks to MVPD competitors because they were delivered terrestrially and not by satellite (and thus not clearly covered by the program access rules). In Philadelphia, San Diego, and Charlotte, the cable-affiliated RSNs were not

[26] DIRECTV's licensing freedom is more restricted by merger conditions imposed by the Commission in approving its transactions with News Corp. and Liberty Media. *See Liberty Media Order*, Appendix B, § III.
[27] *See 2010 Program Access Order*, ¶¶ 30.

licensed to DBS firms;[28] while in New York, the cable-affiliated RSN did not license the HD feed of its programming to Verizon.[29]

However, there is no evidence that Fox – which is not affiliated with an MVPD and which owns 16 RSNs – has licensed any of its RSNs on an exclusive basis to any MVPD or refused to license any of them to any MVPD.[30] Fox is free to do so if it found it more profitable and/or more efficient to do so. Instead, unlike its vertically integrated counterparts that could exploit the terrestrial loophole, Fox has found that it realizes the greatest value from its RSNs by licensing them widely to MVPDs that compete with each other.

IV. Economic Theory Explains Why Exclusive Agreements Between Unaffiliated MVPDs and Programmers Are Rare

Economists long have studied economic incentives for exclusive vertical agreements. The explanation for observed exclusive arrangements differs according to the context in which they arise, but economists have identified both procompetitive (efficiency and competition-enhancing) and anticompetitive motivations for why a distributor will enter into an exclusive arrangement with a supplier.[31]

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[28] "There are three DMAs where [RSNs that offer] the games of some of the local professional sports teams are not available to DBS subscribers: Charlotte, Philadelphia, and San Diego," *MEMORANDUM OPINION AND ORDER In the Matter of Applications for Consent to the Assignment and/or Transfer of Control of Licenses Adelphia Communications Corporation, (and subsidiaries, debtors-in-possession), Assignors, to Time Warner Cable Inc. (subsidiaries), Assignees; Adelphia Communications Corporation, (and subsidiaries, debtors-in-possession), Assignors and Transferors, to Comcast Corporation (subsidiaries), Assignees and Transferees; Comcast Corporation, Transferor, to Time Warner Inc., Transferee; Time Warner Inc., Transferor, to Comcast Corporation, Transferee ("Adelphia Order")*, MB Docket No. 05-192, 7/21/2006.

[29] *See Verizon Tel. Companies and Verizon Svcs. Corp. v. Madison Square Garden, L.P. and Cablevision Sys. Corp.*, 26 FCC Rcd. 13145 (MB 2011) ("Verizon HD Access Order"), *aff'd*, 26 FCC Rcd. 15849 (2011) ("*Verizon HD Access Review Order*"); *AT&T Svcs. Inc. and Southern New England Tel. Co. d/b/a AT&T Connecticut v. Madison Square Garden, L.P. and Cablevision Sys. Corp.*, 26 FCC Rcd. 13206 (MB 2011) ("*AT&T HD Access Order*"), aff'd, 26 FCC 15871 (2011) ("*AT&T HD Access Review Order*").

[30] Fourteen years ago, when Fox's sports networks were affiliated with Liberty (and, through Liberty, to TCI cable), Fox was accused of price discrimination, but not withholding. *EchoStar Comm's Corporation v. Fox/Liberty Networks LLC*, 13 FCC Rcd. 21841 (CSB 1998).

[31] Economists have also studied reasons for vertical integration, which is a related but distinct phenomenon. The benefits of vertical integration (such as problems with the appropriation of specific investments) can differ from those of exclusivity. (*see*, for example, Sanford J. Grossman and Oliver D. Hart, *The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration*, 94 JOURNAL OF POLITICAL ECONOMY 691(1986)). In other cases, vertical integration and exclusives can be alternative ways of solving the same problem or achieving the same objective (such as incentivizing downstream investments in market development or product promotion). The concern in this proceeding is with exclusivity and, in particular, with the impact of the use of exclusivity by cable-

A general finding is that exclusive agreements between firms at different stages of the vertical chain are a common business practice that arises from the desire of both parties to increase their joint profitability. As with other business arrangements, the increased profits from such arrangements can arise either from procompetitive or anticompetitive effects. The economic literature on exclusive dealing can help sort out the likely rationale for a given arrangement. In connection with the Commission's inquiry here, it can help assess whether or not the cable exclusivity prohibition is likely to reduce economic efficiency by preventing efficiency-enhancing exclusive contracts.

A. Exclusivity Provisions Can Increase Efficiency and/or Competition

Economists have identified several procompetitive effects of exclusive vertical arrangements. In general, economic theories rely on how such arrangements change the market-based incentives faced by one of the parties to the arrangement. In essence, the parties attempt to align their incentives through exclusive arrangements, rather than attempting to contract over individual elements of performance. Such solutions are particularly attractive when the desired conduct is difficult to specify and enforce contractually, and when the parties' incentives can be changed by making the vertical relationship exclusive.

Exclusive distribution, where a supplier chooses a single distributor to market its products in a given area or to a given group of consumers, changes distributor incentives by allowing the distributor to capture a greater fraction of the benefits from serving this set of customers. This is particularly important when the supplier wants the distributor to make investments or engage in promotion that enhances the appeal of the product to its customer base beyond making a particular sale. Many examples fit this framework, such as the prevention of free-riding on promotion or incentivizing investments in developing a customer base.[32] Such

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affiliated suppliers. (I do not address the issue of whether it is efficient for firms to vertically integrate – an issue that would require a separate analysis.)

[32] A useful survey of these examples is in Michael L. Katz, *Vertical Contractual Relations*, HANDBOOK OF INDUSTRIAL ORGANIZATION, Vol. 1, at 655-721 (Elsevier, Amsterdam, 1989). A survey of U.S. distribution managers found that "firms are more likely to use exclusive dealing when there is a potential that other manufacturers can free ride on the services they provide" (Jan B. Heide, Shantanu Dutta and Mark Bergen, *Exclusive Dealing and Business Efficiency: Evidence From Industry Practice*, 41 J. LAW AND ECONOMICS 387 (1998).

arrangements can be procompetitive and benefit consumers.[33] I discuss each of these benefits in turn.

1. Creating incentives for expanding the customer base

A distributor will have no incentive to invest in developing its supplier's customer base unless that distributor can capture enough of the benefits of that expansion to make that investment profitable. When several distributors serve the same customer base, the benefits of expanding the customer base are shared across the distributors. This weakens the incentive of any individual distributor to make the required investments. In contrast, when one distributor has an exclusive contract to serve a set of customers, it will capture a greater fraction of the benefits from increasing customer demand and therefore will make more of the desired investments.

Incentives to use exclusives will be greatest when it is easy to assign customers to particular distributors and customers have no strong innate preference to be served by a particular distributor. These considerations explain why salesmen and wholesale distributors frequently are assigned exclusive territories by their supplier. A distributor and/or salesman essentially acquires the exclusive right to serve a set of customers on a relatively long-term basis, which provides an incentive for the distributor/salesman to provide high-quality service and to engage in other activities or "investments," such as product promotion and product demonstrations, that produce future as well as current sales. When it is difficult to measure, and thus to contract for, specific performance, the motivation for entering into exclusive arrangements is enhanced.

For example, consider a wholesale beer distributor that serves a geographic area where the amount of the manufacturer's beer demanded by customers in that area increases when the distributor increases its advertising, marketing, and distribution investments. Granting the

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[33] *See also* Francine Lafontaine and Margaret Slade, *Exclusive Contracts and Vertical Restraints: Empirical Evidence and Public Policy*, HANDBOOK OF ANTITRUST ECONOMICS (2007) (based on a survey of the literature, "we find that in the setting that we focus on, namely manufacturer/retailer or franchisor/franchisee relationships, the empirical evidence …is surprisingly consistent. Specifically, it appears than when manufacturers choose to impose [vertical] restraints, not only do the make themselves better off, but they also typically allow consumers to benefit from higher quality products and better service provision")).

distributor exclusive rights to serve this area encourages it to identify and execute successful market development activities, because the distributor will earn a quasi-rent stream that ensures that it can appropriate the returns to such activities through additional sales. Since there is no intrinsic reason to prefer one distributor over another (for a given level of service), there is no customer preference to overcome when limiting the supply to one distributor.

2. Preventing free-riding on promotional efforts

Exclusive distribution also can help prevent free riding. When multiple distributors sell to the same customer base, distributors can free-ride on the promotional efforts of competing distributors. For example, a distributor can undercut its rivals by offering products at discounted prices, and then explicitly or implicitly encouraging customers to obtain promotional or other services from competing distributors. This problem, brought to prominence by Lester G. Telser,[34] can be solved by exclusive distribution that prevents a distributor from relying on the promotional efforts of its rivals, or equivalently by allowing distributors that provide the desired promotion to reap the benefits of that promotion.

3. Facilitating negotiation of lower prices

Exclusive distribution can allow the distributor to obtain lower prices from suppliers by forcing suppliers to compete for the contract rather than for individual sales.[35] Exclusives can effectively bundle many customers' demands, making these suppliers' demand curves more elastic at the margin. For example, restaurants and venues often offer only one brand of cola – either Pepsi or Coke – but not both. If both brands were available, then suppliers might have an incentive to price high enough to capture sales only from customers with a strong demand for their brand over the other brand, which would result in elevated wholesale and retail prices relative to what can be achieved through competition for the contract. If, however, the restaurant or venue invites Coca-Cola and PepsiCo to bid for an exclusive to supply cola to the outlet, then each has an incentive to offer a lower price because, by doing so, it can win the right to supply

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[34] Lester G. Telser, *Why Should Manufacturers Want Fair Trade?,* 3 J. L.& ECON. 86 (1960).

[35] Benjamin Klein and Kevin M. Murphy, *Exclusive Dealing Intensifies Competition for Distribution*, ANTITRUST L. J (2008); Hans Zenger, *When Does Exclusive Dealing Intensify Competition for Distribution? Comment on Klein and Murphy*, 77 ANTITRUST L. J (2010).

all the cola sold through that outlet (correspondingly, if it bids too high it will lose sales to everyone purchasing at the outlet).[36]

In this way, competition for exclusives changes suppliers' pricing incentives, resulting in lower prices that increase output.

B. Exclusives are More Attractive When They Do Not Limit End-Users' Access to Products

An important feature of many exclusive vertical arrangements is that they do not limit end-users' access to the product. Rather, they simply concentrate distribution in a way that creates value *without restricting consumer access*.

In wholesale distribution exclusives, the manufacturer often grants exclusive geographic territories to its distributors, but assures that all customers have access to the product by covering the entire relevant geographic area (such as the United States or a region within the United States) with exclusive but non-overlapping territories. Consider, for example, the hypothetical given above in which a beer company chooses an exclusive distributor for its beer within a specified geographic area. The intent is not to limit which consumers can purchase that brand of beer, but rather to create incentives for the sole distributor serving a particular territory to expand its marketing efforts in order to increase the brand's penetration and sales. By granting an exclusive territory, the beer manufacturer wants to compete more effectively against other brands of beer within each geographic area (i.e., sell more beer to more consumers), not restrict output. Similarly, exclusive retail distribution is common when final customers can shop across retail outlets (e.g., car dealers, gasoline) since in such cases the supplier can improve incentives without significantly limiting customer access to its product.

The degree to which consumers are willing to switch across distributors has a substantial effect on the incentives to use exclusives as a means of improving efficiency. The greater the

[36] These types of arrangements typically involve exclusivity restrictions in the other direction, where the downstream firm limits the number of suppliers it will use rather than the supplier limiting the number of distributors. The lower prices negotiated as a result of suppliers bidding for the exclusive then expand output. Also, as outlined by Klein and Murphy (2008), these types of contracts typically arise when they involve products that are close substitutes (e.g., alternative brands of tortillas or spices). In contrast, most exclusives used by cable-affiliated MVPDs involve products with few close substitutes (such as RSNs).

customer preference for a particular distributor, the less the benefit and the higher the cost of exclusivity. On the benefit side, when customers have a strong preference for a particular distributor, that distributor will receive more of the benefits of its investments and promotion because the demand it generates likely will stay with it even in the absence of an exclusive. The problems with free-riding, and thus the potential benefits of exclusives, are correspondingly reduced. At the same time, the cost of using exclusives is higher since moving to exclusive distribution will involve a greater loss of customer satisfaction and access. Thus, all else equal, we expect exclusives to be less attractive when consumers are reluctant to move across distributors to obtain access to the product in question. This will commonly be the case when consumers frequently purchase multiple products from the same retailer. In such cases, it can be costly or impractical for a consumer to shop across retailers to find the mix of products he desires.

C. Procompetitive Incentives for Exclusive Vertical Agreements are Unlikely to Motivate Exclusive Programming Arrangements with MVPDs

The economic theory of efficient exclusives shows that procompetitive exclusive arrangements generally create enhanced incentives for distributors to expand sales in situations where exclusives do not limit substantially the supplier's access to customers. This implies that there likely is limited competitive benefit from restricting competing MVPDs' access to programming.

MVPDs are like multiproduct supermarkets; consumers (or viewers) frequently shop for all their needs (in this case programming) at only one multiproduct supermarket (MVPD), so those consumers will not have the opportunity to purchase (view) products (networks) not available in that store (MVPD). Indeed, the limiting effect of exclusives is even greater for MVPDs than for supermarkets. While consumers do sometimes shop at multiple supermarkets, consumers very rarely contract for video services with more than one MVPD.[37]

[37] *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Eleventh Annual Report, 20 FCC Rcd. 2755, App. B, table B-1, note (ii) ("[T]he number of households subscribing to more than one MVPD is expected to be low").

Thus, by limiting distribution of programming to only one of several competing MVPDs, the programmer forsakes the opportunity to gain audience through other MVPDs. This will be profitable only if the programming is sufficiently attractive that it results in large numbers of MVPD subscribers moving from MVPDs that lack the programming to the MVPD that offers the programming, or the exclusive arrangement provides sufficient other benefits to the program supplier or the MVPD that is granted the exclusive. In terms of the impact on economic efficiency, the loss of access *per-se* generally reduces efficiency and would have to be offset by another benefit, such as enhanced investment or service, or by improved pricing (that would expand output). Again, the fact that non-vertically integrated programmers generally do not engage in exclusive arrangements suggest that these conditions are rarely met.

Vertical integration makes an efficiency-based case for MVPD exclusives even harder to justify. The market evidence, and in particular the recent separation of Time Warner Cable (a MVPD) from Time Warner Inc. (which owns national programming networks), and the general decline in the percentage of satellite-delivered national networks that are cable affiliated,[38] suggests that the benefits of vertical integration are not great.[39] But even if the gains to vertical integration were large, many operational and promotional efficiencies from vertical integration do not require exclusivity.[40] To the extent that the integrated MVPD has advantages because it can coordinate better with the programmer, it will be able to monetize this value without simultaneously denying access to subscribers of competing MVPDs. As explained above, the general rationale for exclusive distribution is that it increases the incentive for the distributor to make investments in developing the market and promoting the product, because it allows the distributor to capture the return on those investments without fear of free riding by other distributors. In the case of vertically integrated distribution, the incentive to invest can be generated through internal control mechanisms that align incentives within the firm, which reduces the need to rely on the market-based incentives generated by exclusive distribution.

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[38] *Notice,* ¶26.

[39] *Notice,* ¶17-18. However, the Commission noted that, since 2007, "the number of cable-affiliated RSNs has increased from 18 to 31 (not including HD versions)." *Notice,* ¶34.

[40] In principle, the prohibition on the use of exclusives by cable-affiliated programmers would discourage efficient vertical integration since program suppliers would have to forgo the use of exclusives in order to gain the other benefits of vertical integration. However, this is not a significant concern here since non-integrated suppliers rarely use exclusives and integration would likely reduce the need for exclusives.

Accordingly, vertically integrated MVPDs should have less need for exclusives to the extent those exclusives are designed to incentivize non-contractible investments in promotion and other distributor efforts.[41]

The nature of the services provided by MVPDs makes it unlikely that even non-integrated suppliers (who should have the greatest need for exclusives under the standard efficiency theories) would rely on exclusivity. In particular, exclusives should be rare because:

- MVPDs generally do not supply the type of promotional services that are subject to the kind of inter-retailer externalities that generate the need for exclusives (promotion that increases the demand for the program supplier's content at other MVPDs rather than helps the MVPD increase its own sales).[42] Other promotion-related elements (e.g., tiering decisions, pricing) appear to be easily contractible and are in fact often specified contractually.

- MVPDs do not need to make long-term investments specific to programming.

- Video programming has low marginal supply costs (often negative for advertiser-supported networks), making restricted distribution costly and inefficient.

- Consumers of MVPD services typically buy from only one MVPD, which implies that exclusivity is likely to result in a significant reduction in the ability to reach end consumers.

- Differentiation across MVPDs is not required in order to achieve product variety. Individual MVPDs can and do offer multiple packages, and the expanded bandwidth

[41] Although it is possible that vertically integrated firms can use exclusives to solve the types of incentive problems outlined above because they have other mechanisms to prevent adverse responses generated by the lack of competition, I point out below that the types of services MVPDs provide to program suppliers do not seem to fit this paradigm.

[42] In fact, the successful promotion of the supplier's programming by one MVPD could very well reduce the number of subscribers to that same programming through the MVPD's competitors by inducing subscribers interested in that programming to select that MVPD over its rivals.

available to cable MVPDs, DBS, and others likely makes this even truer today than in the past. This further reduces the need for exclusives.[43]

Taken together, these factors imply that there likely is little benefit from MVPD exclusives and non-trivial costs in lack of access to customers. Not surprisingly, as I showed above, we see very few exclusive relationships between non-vertically integrated program suppliers and MVPDs.

D. The Type of Programming that has been Distributed on an Exclusive or Limited Basis Suggests a Value-Capture Rather than Efficiency Explanation

Some programming is particularly effective at attracting customers to an MVPD. When the value of programming varies substantially across customers, it can be difficult to capture a large share of the potential value generated by that programming by charging customers directly (i.e., by selling it as a separate premium service). If the programming is priced low, then value is collected from more customers, but not the additional value from those with more intense preferences for the programming. If the price is high, then more is collected from customers that value the programming highly, but none from customers that place a lower but still significant value on the programming.

One way the program supplier can capture more value than it could through a single price is to target that programming for inclusion in one of the MVPD's popular programming tiers (so that it obtains a broad audience), and then charge a licensing fee to the MVPD that reflects the ability of that programming to attract subscribers to the MVPD. MVPDs will be willing to pay high fees because the programming attracts additional subscribers to their service, including a relatively large number of customers that place a high value on the programming and a relatively smaller number of customers that value it less highly. In this way, the program supplier effectively collects its return based on the value provided to both high and low value customers.

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[43] For example, DIRECTV currently markets at least five major service tiers and Comcast currently markets at least three major service tiers, in addition to premium channels available a la carte. English Packages – DIRECTV, http://www.directv.com/DTVAPP/new_customer/base_packages.jsp?footernavtype=-1&lpos=header; XFINITY TV Channels, Comcast.com, http://www.comcast.com/Corporate/Learn/DigitalCable/TVChannelLineUp.html.

Sports networks are an example of this type of pricing. They have high license fees relative to advertising revenues (capturing the ability of the network to draw customers), as shown in Table 1**,** which ranks networks by the ratio of per-subscriber fees to ad revenues. ESPN represents perhaps the best known example, but sports networks in general tend to have relatively high license fees, reflecting the ability of these programs to draw and retain subscribers.

As I demonstrated in my submission in the Comcast-NBCU proceeding, vertically integrated MVPDs have an incentive to charge higher license fees for programming that is particularly effective in gaining MVPD subscribers than do non-vertically integrated MVPDs. This is because, if no carriage arrangement is reached, they can capture as additional subscribers some of the customers that the competing MVPD will lose if it did not carry the network. As I show below, when licensing affiliated programming has a large competitive impact on MVPD prices, the incentive to withhold can be sufficiently strong that there may be no gains from trade between the parties, and hence no carriage arrangement will be reached. In this situation, the vertically integrated MVPD will maintain an exclusive, even though a non-vertically integrated supplier of the same programming still would profit from dealing with the rival MVPD.

V. An Economic Framework and Model for Evaluating the Effects of Vertical Integration on the Incentives to License Programming

The incentive for vertically integrated MVPDs to withhold programming from rivals – and thus be the exclusive distributor of this programming – can be analyzed using a simple economic model of bargaining between unaffiliated MVPDs and a programming supplier that is vertically integrated with a MVPD.. The vertically integrated MVPD can increase its profits through exclusivity by making its competitors' product offerings less attractive, thereby reducing the need for it to cut prices in order to win subscribers. However, because this requires a sacrifice of licensing and advertising revenues that its affiliated programmer otherwise could earn by licensing to the MVPD rival, a vertically integrated firm will find it in its interest to withhold the programming from its rival only when the gain from the reduced competitive pressure exceeds the loss of licensing and advertising revenues.

As my model shows, all else equal, a vertically integrated MVPD's incentive to withhold programming from MVPD rivals is greater when (a) the integrated MVPD has a greater market share (because it forgoes access to fewer subscribers), (b) the programming earns lower advertising revenues per subscriber (because it forgoes less ad revenue), (c) the programming plays a more important role in motivating customers' choice among MVPDs (i.e., the diversion rate is high), and d) a competitor's access to the programming would create competitive pressure on the affiliated MVPD to cut prices. With respect to (c), this tends to be the case when the programming is very popular and non-replicable, including live sports events and other programming that the FCC has characterized as "marquee" programming.[44]

Even when it does not have an incentive to withhold completely, an MVPD that controls programming may have different pricing and tiering incentives than do non-integrated programmers. The integrated MVPD may have an incentive to allow its programming to be available only on competitors' higher-priced tiers, which could have an analogous economic effect to withholding the programming entirely.

A. An Economic Model

I illustrate the incentives of vertically integrated suppliers to use exclusives with a simple model of bargaining between a program supplier and an individual MVPD. It is possible to use many different models and alternative assumptions, but the model below is simple and provides insight into the primary incentive effects. I build on the framework that I used to analyze the potential impact on competition from Comcast's acquisition of NBCU, a framework that the FCC subsequently employed in its analysis of the competitive effects of vertical integration.[45]

To keep things simple, I consider a market with two MVPDs (MPVD_0 and MPVD_1). My goal is to illustrate conditions under which a program supplier would find it profitable to refuse to supply (i.e., not reach a deal to supply) programming to one of the MVPDs and instead supply the other MVPD exclusively.

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[44] *Applications of Comcast Corp., General Electric Co. and NBC Universal, Inc.*, 26 FCC Rcd. 4238, ¶ 36 (2011) ("*Comcast/NBCU Order*")

[45] Kevin M. Murphy, *Economic Analysis of the Impact of the Proposed Comcast/NBCU Transaction on the Cost to MVPDs of Obtaining Access to NBCU Programming* (attached to Comments of DIRECTV, Inc., MB Docket No. 10-56 (filed June 21, 2010)) ("*Murphy Comcast/NBCU Report*"); *Comcast/NBCU Order*, at App. B, at *passim*.

To fix ideas, I start by assuming no vertical integration and consider the factors affecting negotiations between the program supplier and $MVPD_1$, assuming that the program supplier supplies $MVPD_0$. (I consider later negotiations when the program supplier and $MVPD_0$ are vertically integrated.) I address the question whether the program supplier will reach agreement to supply $MPVD_1$ (whether trade will occur) and, if it does, the factors that influence the resulting license fee.

Whether the two parties reach a deal depends on their payoffs with and without a deal. To keep things simple, I assume the programming would be part of $MVPD_1$'s basic network package (no separate charge to the end user), but allow the price of this basic package to change if the programming is licensed.

The payoff to $MVPD_1$ depends on the price it charges for its product (P_1), its number of subscribers (Q_1), its variable costs per subscriber other than the cost of the programming being negotiated (C_1), and the license fee it pays for this programming if it licenses the network (L_1). The payoff to the program supplier depends on the license fee it charges to $MVPD_1$ (L_1), the license fee it charges the other MVPD (L_0), its ad revenue per subscriber (R), and the number of subscribers of each MVPD. I denote the case where the programming is supplied to $MVPD_1$ by Y (for yes) and the case where programming is not supplied by N (for no). If there is no agreement between them, then the payoff to the program supplier (S) and $MVPD_1$ will be:

$$\begin{aligned} S(N) &= Q_0(N)(R+L_0) \\ MVPD_1(N) &= (P_1(N)-C_1)Q_1(N) \end{aligned} \tag{1}$$

These payoffs reflect the fact that, with no agreement with $MVPD_1$, the program supplier obtains advertising and licensing revenue from $MVPD_0$ but not from $MVPD_1$. If the program supplier and $MVPD_1$ reach an agreement, the corresponding payoffs are:

$$\begin{aligned} S(Y) &= Q_0(Y)(R+L_0)+Q_1(Y)(R+L_1) \\ MVPD_1(Y) &= (P_1(Y)-C_1-L_1)Q_1(Y) \end{aligned} \tag{2}$$

The question of whether there are gains from trade if the supplier and $MVPD_1$ reach a licensing agreement amounts to whether their combined payoffs from reaching a deal, T(Y), exceeds their combined payoffs without a deal, T(N). Using equations 1 and 2, these combined payoffs are

3) $$\begin{aligned} T(Y) &= Q_0(Y)(R+L_0)+Q_1(Y)(R+P_1(Y)-C_1) \\ T(N) &= Q_0(N)(R+L_0)+Q_1(N)(P_1(N)-C_1) \end{aligned}$$

The gains from trade, GFT, equal the difference between *T(Y)* and *T(N)*, or

4) $$\begin{aligned} GFT &= (Q_0(Y)+Q_1(Y)-Q_0(N))R+(Q_1(Y)-Q_1(N))(P_1(Y)-C_1)+ \\ &Q_1(N)(P_1(Y)-P_1(N))-(Q_0(N)-Q_0(Y))L_0 \end{aligned}$$

Equation 4 shows that the gains from trade consist of four terms: (1) the gain in advertising revenues generated by the increase in total viewers of the programming from extending the license to $MVPD_1$; (2) the margin earned by $MVPD_1$ on the additional viewers it gains if it adds the programming; (3) the increase in price $MVPD_1$ realizes from the improvement in the product it provides to consumers generated by adding the additional programming, and (4) the loss of revenues to the program supplier from the decrease in subscribers to $MVPD_0$ (because some subscribers move to $MVPD_1$). A sufficient set of conditions for positive gains from trade (and thus for $MVPD_1$ to license the programming) is that (a) total subscribers to the network increase (i.e., $Q_0(Y)+Q_1(Y)>Q_0(N)$), (b) the total margin earned by $MVPD_1$ (not including the license fee paid to the supplier) is at least as large as the license fee paid by $MVPD_0$ (i.e., $MVPD_1$ could earn a positive margin if it paid the license fee paid by $MVPD_0$), (c) the price $MVPD_1$ can charge does not fall when it adds additional content, and (d) total subscribers to the two MVPDs combined do not decrease.[46] It is reasonable to assume that conditions (a), (b) and (c) will be met: the number of network subscribers will increase with the addition of $MVPD_1$, $MVPD_1$ will charge at least as high a price when it has more content, and $MVPD_1$ will earn a positive margin at the going license price (L_0). This means that gains from trade will be positive whenever the number of subscribers to the two MVPDs does not decline (i.e., $Q_1(Y)+Q_0(Y)\geq Q_1(N)+Q_0(N)$); that is, whenever there is no decline in combined MVPD subscribers, which again is what would be expected. Thus, under plausible conditions, the supplier will find it profitable to serve $MVPD_1$ in addition to $MVPD_0$.

[46] (c) and (d) combined imply that the second and fourth term combined are positive.

I now consider how bargaining differs when the supplier is vertically integrated with $MVPD_0$. The gains from trade with $MVPD_1$ change because the programming supplier now internalizes any impact that licensing $MVPD_1$ has on the profits of $MVPD_0$. In particular, the payoffs without agreement now are:

5)
$$\begin{aligned} S(N) &= Q_0(N)(P_0(N) - C_0 + R) \\ MVPD_1(N) &= Q_1(N)(P_1(N) - C_1) \end{aligned}$$

while the returns to the two parties from reaching an agreement are:

6)
$$\begin{aligned} S(Y) &= Q_0(Y)(P_0(Y) - C_0 + R) + Q_1(Y)(L_1 + R) \\ MVPD_1(Y) &= Q_1(Y)(P_1(Y) - C_1 - L_1) \end{aligned}$$

The corresponding total payoffs are:

7)
$$\begin{aligned} T(Y) &= Q_0(Y)(P_0(Y) - C_0 + R) + Q_1(Y)(P_1(Y) - C_1 + R) \\ T(N) &= Q_0(N)(P_0(N) - C_0 + R) + Q_1(N)(P_1(N) - C_1) \end{aligned}$$

This implies that total gains from trade from licensing $MVPD_1$ when the programming supplier is integrated with $MVPD_0$ is

8)
$$\begin{aligned} GFT_{VI} &= (Q_0(Y) + Q_1(Y) - Q_0(N))R - (Q_0(N) - Q_0(Y))L_0 + \\ &(Q_1(Y) - Q_1(N))(P_1(Y) - C_1) + Q_1(N)(P_1(Y) - P_1(N)) + \\ &(Q_0(Y) - Q_0(N))(P_0(Y) - C_0 - L_0) + Q_0(N)(P_0(Y) - P_0(N)) \end{aligned}$$

Comparing the expressions for the gains from trade under the vertical integration scenario (equation 8) with gains from trade without vertical integration (equation 4) shows how vertical integration changes the nature of the programming supplier's incentives.[47] The terms in the first and second lines of equation 8 appear in both equations, and represent the change in advertising revenues and license fees from $MVPD_0$ for the programming supplier and the change in the profits (before the licensing fees) of $MVPD_1$, respectively. The difference between the two cases is the third line of equation 8, which reflects how the programming supplier internalizes the

[47] Some caution needs to be taken when comparing across the vertically integrated and non-vertically integrated cases. Because there are different pricing incentives in the two cases, the price and quantity outcomes can be somewhat different for each of the states (N and Y) under the VI and non-VI scenarios. The analysis I present here is intended to illustrate the differences in the economic forces that operate in the two cases.

profit impact on $MVPD_0$ from licensing programming to $MVPD_1$. To understand the incentives to deal in the vertically integrated case, it is instructive to simplify some of the terms and re-write equation 8 as

$$9)\quad \begin{array}{l} GFT_{VI} = (Q_0(Y) + Q_1(Y) - Q_0(N))R + (Q_1(Y) - Q_1(N))(P_1(Y) - C_1) + \\ Q_1(N)(P_1(Y) - P_1(N)) + Q_0(N)(P_0(Y) - P_0(N)) - (Q_0(N) - Q_0(Y))(P_0(Y) - C_0) \end{array}$$

Equation 9 makes clear that, unlike in the non-vertically integrated case, the lost license fees from $MVPD_0$ drop out (since they are simply transfers within the firm in the vertically integrated case) and now are replaced by the larger loss of profits to the combined entity from the lost sales, $(Q_0(N)\text{-}Q_0(Y))(P_0(Y)\text{-}C_0)$. The forces that determine whether programming will be withheld in the vertically integrated case can be seen more clearly by making the simplifying assumption that the margins of the two MVPDs are equal (when both sell the same package of programming), so that the expression for the gains from trade with vertical integration (equation 9) reduces to:

$$10)\quad \begin{array}{l} GFT_{VI} = (Q_0(Y) + Q_1(Y) - Q_0(N))R \\ +(Q_0(Y) + Q_1(Y) - Q_0(N) - Q_1(N))(P_1(Y) - C_1) \\ +Q_1(N)(P_1(Y) - P_1(N)) + Q_0(N)(P_0(Y) - P_0(N)) \end{array}$$

Equation 10 shows that the gains from trade consist of three terms: (1) the gain in advertising revenue obtained by expanding programming output, (2) the additional profits earned from expanding total MVPD output, and (3) two terms that reflect the effect on the pricing of $MVPD_0$ and $MVPD_1$. Gains from trade under the non-vertically integrated scenario (equation 4) can be written in a similar form as

$$11)\quad \begin{array}{l} GFT = (Q_0(Y) + Q_1(Y) - Q_0(N))R \\ +(Q_0(Y) + Q_1(Y) - Q_0(N) - Q_1(N))(P_1(Y) - C_1) \\ +Q_1(N)(P_1(Y) - P_1(N)) + (Q_0(N) - Q_0(Y))(P_0(Y) - C_0 - L_0) \end{array}$$

The first two terms in equation 11 have the same form as those in equation 10 and capture the output-expansion effects of licensing to $MVPD_1$. The next term is again the same as that in the vertically integrated case and captures the effect on the price charged by $MVPD_1$. The final term differs from the vertically integrated case due to the different treatment of the effect on $MVPD_0$ in the two cases. In the vertically integrated case, the gains from trade are reduced due to the downward pressure on $MVPD_0$'s price caused by $MVPD_1$'s improved programming lineup. In contrast, in the non-vertically integrated case shown in equation 11, the gains from trade (and hence the incentive to deal) instead are augmented by the margin loss of $MVPD_0$ from subscribers moving to $MVPD_1$. This difference in how the loss of profits to $MVPD_0$ are treated in the two cases explains why vertically integrated programmers can have an incentive to withhold programming from MVPD competitors, even when non-vertically integrated programmers would not.[48]

Equation 10 also identifies three conditions that make it likely that a vertically integrated programming supplier will refuse to license to a rival MVPD:

1. Advertising revenues (R) are low relative to the impact on subscribers and MVPD margins;
2. There is little change in the overall number of subscribers (e.g., the MVPD market is mature with few marginal buyers of MVPD services); and
3. The competitive impact of licensing on MVPD prices is large (i.e., rival MVPDs compete aggressively when they get access to programming, which forces the vertically integrated cable operator to respond by reducing prices).

As I explain below in Section V.B, this last condition is especially important, but seems to not have been the focus of past proceedings. Before doing so, however, I note an additional issue regarding the impact of cable service "bundles" on my model. Equation 10 was based on the assumption that the two MVPDs have the same margin when both have access to the same

[48] The analysis of withholding presented here for the non-integrated case assumes that the programmer deals with each MVPD independently. This is the framework used by the FCC in past proceedings and the one I adopted in my previous work. In principle, one could consider a variety of bargaining frameworks that involve different coalitions of the parties or different contracting structures. For example, one could consider the case where a coalition of $MVPD_0$ and the program supplier negotiates with $MVPD_1$. This of course would yield the same outcome as in the vertically integrated case, because the parties would achieve by contract the same outcome they achieve by vertical integration. However, while cooperation between the supplier and $MVPD_0$ is natural in the vertically integrated case, there is no particular reason why that coalition would form in the absence of integration. Moreover, as I discuss elsewhere in this report, there is evidence that withholding decisions of vertically integrated suppliers differ from those of non-vertically integrated suppliers, which I interpret as evidence that the parties' interests are not fully aligned absent integration. However, it is important to note that the issues of coalition formation do not affect my analysis of the vertically integrated case (which is the focus of this inquiry) since there are only two parties to the bargaining process in that case.

programming. If the two MVPDs have different incremental margins on gaining a subscriber, then the formula has an additional term. In particular, equation 10 becomes

$$\begin{aligned} GFT_{VI} &= (Q_0(Y)+Q_1(Y)-Q_0(N))R \\ &+(Q_0(Y)+Q_1(Y)-Q_0(N)-Q_1(N))(P_1(Y)-C_1) \\ &+Q_1(N)(P_1(Y)-P_1(N))+Q_0(N)(P_0(Y)-P_0(N))- \\ &(Q_0(N)-Q_0(Y))[(P_0(Y)-C_0)-(P_1(Y)-C_1)] \end{aligned} \tag{12}$$

The last term measures the loss (gain) from shifting volume from $MVPD_0$ to $MVPD_1$ when $MVPD_0$ has a higher (lower) margin than $MVPD_1$. When the integrated supplier earns a higher margin on an additional subscriber than does the competing MVPD, this term further reduces the incentive for the vertically integrated supplier to share programming. This could be the case with cable relative to DBS, because cable can provide Internet and phone service as well as video, and earn the additional margin on those services (or on the bundle).[49] Moreover, to the extent that the triple play continues to grow in importance over time, the incentives of vertically integrated cable operators to withhold may be greater in the future than they are today or were in the past.

B. Implications of the Model for the Proceeding

The economic framework presented above helps explain (at least in part) why RSNs have been the subject of exclusives by cable-affiliated programmers, and why other programming with a strong ability to attract subscribers (and thus command relatively high fees) could be the subject of exclusives if the rules permitted. Sports programming has a large value to end users, as evidenced by relatively high license fees and relatively low advertising revenues compared to ratings and fees.[50] This makes it more likely that an MVPD that provides this programming will be able to charge its MVPD rivals higher prices that reflect the added value to the rival and the

[49] Even if the ability to offer the triple-play and other bundles is good for consumers in other respects, it could generate the incentive for a cable supplier to withhold programming it otherwise would have the incentive to supply.
[50] The high level of fees reflects the programming's ability to increase the demand for the MVPDs service allowing the MVPD to charge higher prices and/or attract more subscribers.

implicit costs to the integrated supplier from lost subscribers. At the same time, a rival MVPD that lacks access will be forced to charge lower prices or suffer a loss of subscribers.[51]

The model also shows that that there can be an incentive for vertically integrated programmers to refuse to license programming to competing MVPDs. *Importantly, this incentive is greatest when the competitive harm to consumers is greatest, and thus the benefits to consumers would be greatest if the prohibition is extended and licensing occurs*. In particular, the affiliated programmer has the incentive to withhold when licensing the affiliated programming to a competing MVPD would result in the greatest downward pressure on the price the vertically integrated cable operator charges consumers for its MVPD service and when the competing MVPD takes the benefits from having access to the programming largely by competing for additional subscribers rather than raising prices. In practice, these two conditions are likely to go together since, if the competing MVPD does not raise price but instead attempts to take its gains from program access in increased sales, the integrated cable operator likely will be forced to cut price to match the lower quality-adjusted price offered by its competitor.

To illustrate with a simple example, assume $MVPD_1$ does not have access to an RSN's programming but $MVPD_0$ does. Then presumably (all else equal) $MVPD_0$ can charge a higher price to subscribers because it has a higher quality product. If $MVPD_1$ later gets access to the programming and thus raises the quality of its offering, it will see an increased demand for its service (i.e., more subscribers at any given price). It can take the benefit of this increased demand either by raising price or increasing the number of subscribers (or a combination of the two). For example, it could increase its price to meet that charged by $MVPD_0$ or it could continue to price below $MVPD_0$ and take some or all of its gains in the form of more subscribers. In the latter case, $MVPD_0$ would have to respond by lowering its price to meet the competition from $MVPD_1$. When licensing the competing MVPD creates substantial pricing pressure on the vertically integrated MVPD, it will not be in the interest of the integrated firm to license. In contrast, if licensing to a competing MVPD does not create pricing pressure on the vertically integrated MVPD (because the competing MVPD simply raises price to consumers when it adds

[51] The lower per-subscriber costs from not having the RSN fees would also push in this same direction.

the programming), then the vertically integrated programmer will charge a high price to competing MVPDs for access but will not refuse to provide access.

C. Conclusion

Vertically integrated programmers will find it in their interest to withhold precisely when withholding has the worst price impacts for consumers, i.e., in those cases where the prices of the vertically integrated MVPD would fall the most and its competitor's prices would increase the least if the rival MVPD had access to the programming. The competitive conditions where extending the cable exclusivity prohibition likely will benefit consumers the most through price competition are those where the vertically integrated firm has the greatest incentive to refuse to license.

Vertically integrated cable companies may claim that the cable exclusivity prohibition is unnecessary because they have no incentive to refuse to provide their programming to competing MVPDs. For much of their programming they may be right, because they prefer to offer their programming to competing MVPDs, albeit at a price higher than the MVPD would pay if the programmer were not vertically integrated.[52] However, those cases where they would find it in their interest to withhold are the ones where charging a high price to a competing MVPD is not as profitable a strategy as refusing to supply the programming altogether. Those are cases where the competing MVPD would put too much downward pressure on the vertically integrated cable company's price, and so where extending the prohibition can benefit consumers (although not the cable-affiliated programmer).

While the incentives to refuse to license are high for RSNs and similar programming that individually are very attractive to viewers, the incentive to refuse to license to competitors extends to bundles of networks – including national networks – that collectively can create large value for viewers, even when their components do not have a high value individually. The current program access rules, which apply to all of the programming supplied by a vertically

[52] The effect of vertical integration on pricing incentives was covered in my submissions in the Comcast-NBCU proceeding.

integrated cable MVPD, assure that competing MVPDs can have access to such bundles.[53] Limiting the applicability of the program access rules to RSNs and similar individual programming networks would not prevent affiliated programmers from refusing to license bundles of other national networks. Withholding such a bundle of programming could have the same adverse impact on consumers as withholding access to an RSN or other "marquee" network.

VI. Exclusive Licensing of NFL Sunday Ticket to DIRECTV is Consistent with the Economic Framework

I explained above that economic models of efficiency-enhancing effects of exclusives and of bargaining between program suppliers and MVPDs show that non-vertically integrated program suppliers would not frequently utilize exclusives. Empirical evidence is highly consistent with this prediction. The history of exclusive licensing of NFL Sunday Ticket by DIRECTV is an exception to this empirical regularity. But even this exception is consistent with the general economic framework described above.

I explained above that an important reason why non-vertically integrated program suppliers do not license exclusively is that it is costly to forgo customers that prefer other MVPDs, and so give up all revenues (including advertising revenues) from customers that remain with the unlicensed MVPDs. However, in the case of NFL Sunday Ticket, the NFL can recapture some of this lost revenue in the form of advertising revenues from games broadcast on local channels at the same time as the programming provided through Sunday Ticket. Indeed, since viewers of Sunday Ticket do not receive local advertising, advertising revenues for the broadcast networks (and hence indirectly for the NFL) are actually higher for those that view NFL games on local broadcast channels. In the model outlined above, this could even reverse the sign on the advertising effects, making it costly rather than beneficial to have broad distribution of Sunday Ticket. Essentially, Sunday Ticket can be thought of as vertical product differentiation in which the program supplier (the NFL) provides the major substitute for its own product.

[53] This is analogous to my discussion in my initial report in the Comcast-NBCU proceeding, where I explained that my bargaining framework applies not only to individual networks but also "blocks" of networks. *Murphy Comcast/NBCU Report* at 22.

In addition to pricing incentives, there are several other reasons for the historical licensing arrangement between the NFL and DIRECTV. In particular,

1. When NFL Sunday Ticket was developed (in 1994), cable suppliers lacked the channel capacity to offer programming that sometimes required at least 10 channels and was broadcast only one day per week four months out of the year. DBS and C-band were the only technologically viable options.[54]

2. Given that DIRECTV had the installed base of Sunday Ticket customers as a result of its initial technological advantages, it made sense for the NFL to continue to license through DIRECTV. Essentially, the customer gain from adding additional MVPDs was smaller than it would have been if DIRECTV's existing customer base did not already include a disproportionate share of households with a high willingness to pay for Sunday Ticket.

3. The NFL has obtained substantial value from DIRECTV because Sunday Ticket helped DIRECTV attract and retain customers. It has been reported that DIRECTV "collects only around $600 million from its roughly 2 million Sunday Ticket subscribers,"[55] while paying about $1 billion to the NFL annually.

VII. Without the Cable Exclusivity Prohibition, Vertically Integrated Cable Companies Could Find it Profitable to Withhold Some Programming from their MVPD Rivals

I explained above that there likely are very limited efficiencies from exclusive licensing agreements between MVPDs and programmers. I also explained why economic theory suggests that a vertically integrated cable operator could have an incentive to withhold programming to disadvantage other MVPDs and thus limit the competition they face. The limited empirical evidence suggests that cable-affiliated programmers could refuse to license at least some of the programming that they control, including RSNs and other "marquee" content, if the prohibition

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[54] "[T]he NFL signed a deal in 1994 to beam Sunday Ticket over startup satellite carrier DirecTV … before digital cable, most cable carriers lacked the bandwidth to show multiple viewer-elected channels simultaneously, so in the 1990s, Sunday Ticket probably couldn't have gone on cable anyway." "It's time to open up NFL Sunday Ticket to everyone," Gregg Easterbrook, ESPN.com (Nov. 1, 2007).

[55] *See,* http://www.multichannel.com/article/190869-DirecTV_s_Sunday_Ticket_Renewal_Sets_NFL_Network_s_Game_Plan.php

on exclusivity were eliminated.[56] The evidence also shows that the consequence could be weaker competition between cable MVPDs that withhold affiliated content and their MVPD competitors.

The primary empirical evidence that integrated cable companies might withhold programming derives from conduct permitted under the so-called "terrestrial loophole" that allowed exclusivity for terrestrially delivered, cable-affiliated programming. Before the Commission closed this loophole,[57] there were several cases in which cable-affiliated RSNs refused to license programming to competing MVPDs, most notably Comcast SportsNet Philadelphia and Cox 4 San Diego.[58] In terms of the overall quantity, this is a relatively small amount of withholding. But it represents a substantial percentage of the programming that cable-affiliated programmers *could* withhold, suggesting that the conditions that motivate withholding are not rare (at least for RSNs). Indeed, with respect to terrestrially delivered, cable-affiliated RSN programming, withholding from at least some competitors in some respects appears to have been common.

The competitive impact on DBS penetration of its lack of cable-affiliated RSNs was examined in two studies during the Adelphia proceeding.[59] These studies used similar regression frameworks, which related the DBS penetration rate to dummy variables for DMAs in which the terrestrial loophole allowed cable MVPDs to withhold RSNs from competitors, conditional on a series of controls. The FCC's analysis found that the DBS penetration rate in Philadelphia, San Diego, and Charlotte was lower than in other "control" markets, although the difference was not statistically significant in Charlotte. Analysis by Lexecon, conducted on behalf of DirecTV,

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[56] My theoretical analysis indicates that integrated MVPDs can have an incentive to refuse to license other programming as well, including programming that is licensed as part of bundles that collectively have a high value to consumers.

[57] *See generally 2010 Program Access Order.*

[58] "Comcast has withheld [Comcast SportsNet Philadelphia], which carries regional professional sports programming in Philadelphia, from DBS firms. This RSN was the subject of previous program access complaints, which were denied because [it] was terrestrially delivered and thus beyond the scope of the program access rules…"*First Report and Order In the Matter of Review of the Commission's Program Access Rules and Examination of Programming Tying Arrangements*, MB Docket No. 07-198, FCC, 1/20/2010, p. 22. This contrasts with licensing practices for Fox, which as far as I know, Fox generally has been willing to offer to license its RSNs to all MVPDs.

[59] *Adelphia Communications Corp., Time Warner Cable Inc., and Comcast Corp.,* 21 FCC Rcd. 8203, ¶ 138-46 and App. D (2006*). See also ANALYSIS OF POTENTIAL ANTICOMPETITIVE EFFECTS OF THE PROPOSED ADELPHIA/COMCAST/TIME WARNER TRANSACTIONS*, Compass Lexecon.

found that the DBS penetration rate in Philadelphia, San Diego, and New Orleans was lower than in other "control" markets, though the difference was not statistically significant in San Diego. [60]

Evidence from other programming limitations reinforces the conclusion that exclusivity reduces the competitive strength of rivals. Until 1999, DBS firms were not allowed to distribute the signals of local broadcast stations into local markets, which effectively made cable the only MVPD with retransmission rights (although some DBS viewers could augment their service with antennas that allowed them to receive broadcast signals over the air). Passage of the Satellite Home Viewer Improvement Act in late 1999 relaxed this restriction, and DBS firms gradually began to roll out "local-into-local" service across local markets. In my initial report in Comcast/NBCU, using evidence from a study by Klein, et al on behalf of DIRECTV, I found that adding local channels to DIRECTV's lineup was associated with a **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** increase in its subscribership over the two-and-a-half years after the channels were added. [61] Allowing DBS firms access to broadcast networks – that is, eliminating cable MVPDs' *de facto* exclusivity – enhanced their ability to compete successfully for subscribers.

Further evidence from this same experience suggests that firms that gain access to additional programming realize the majority of their gains in the form of increased subscribers rather than higher prices. In my initial report in *Comcast-NBCU*, I used evidence from Klein, et al.'s analysis of the introduction of "local-into-local" to infer the extent to which DIRECTV took the gains from increased demand resulting from access to local broadcast signals in the form of higher prices versus higher quantities. I found that it took the vast majority of these gains **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** in higher quantities and only **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** in the form of higher prices.[62] The effort (and success) of DBS to attract subscribers based on their improved content provided for stronger competition vis-à-vis cable MVPDs. That stronger competition showed up in the form

[60] *Adelphia Communications Corp., Time Warner Cable Inc., and Comcast Corp.,* 21 FCC Rcd. 8203, ¶ 138-46 and App. D (2006). *See also ANALYSIS OF POTENTIAL ANTICOMPETITIVE EFFECTS OF THE PROPOSED ADELPHIA/COMCAST/TIME WARNER TRANSACTIONS*, Compass Lexecon.
[61] *Murphy Comcast/NBCU Report*, Appendix A.
[62] *Id.*

of higher shares for DBS firms (which is consistent with a reduction in the quality-adjusted price of their product).

VIII. Conclusion

The analysis I presented above shows that vertically integrated programmers find it in their interest to withhold precisely when withholding has the worst price impacts for consumers, i.e., when the prices, charged by the vertically integrated MVPD would fall the most and its competitors' prices would increase the least with access to the programming. Since the theoretical and empirical economic evidence suggest that there would be little if any loss of other efficiencies from continuing the prohibition, its continuation could provide non-cable MVPDs with important programming that they otherwise would lose, and could prevent withholding in those cases where program access would have the largest competitive benefits to consumers.

Table 1
2010 Annual Network Statistics
Limited to Networks With Total Revenue Greater Than or Equal to 200M

		In Millions			*Avg. Est. Households Delivered [Thousands]*		
Network	***Network Type***	***Subscribers at Year End***	***License Fee Revenue***	***Net Advertising Revenue***	***Prime Time***	***24 - Hour***	***License Fee to Net Ad Rev***
MSG Plus	RSN	7.8	197.5	21.0	12	4	940.3%
BTN	BASIC	46.5	200.5	24.5			817.2%
FOX Sports Southwest	RSN	8.1	236.7	32.3	45	16	733.0%
YES Network	RSN	11.9	371.1	53.8	85	37	689.5%
NFL Network	BASIC	56.8	522.5	80.0	181	87	653.3%
Comcast SportsNet Washington	RSN	4.7	179.9	28.4	21	7	632.9%
SportsNet New York	RSN	7.4	193.2	32.6	59	20	592.0%
FOX College Sports	BASIC	42.5	176.1	36.0			488.9%
Madison Square Garden Network	RSN	7.8	223.5	47.2	29	9	473.8%
FOX Sports West	RSN	7.2	201.3	43.4	39	13	464.0%
MLB Network	BASIC	55.2	159.4	40.8	45	31	390.3%
ESPN/ESPN HD	BASIC	99.8	5,235.6	1,585.2	1,676	801	330.3%
NBC Sports Network	BASIC	75.2	229.4	70.4	49	76	326.0%
ESPNews	BASIC	73.4	153.2	52.5	65	52	291.7%
ESPN2	BASIC	99.7	689.0	265.1	404	247	259.9%
SPEED	BASIC	77.3	188.7	82.2	134	110	229.5%
Golf Channel	BASIC	83.2	259.6	113.9	84	63	228.0%
CNN	BASIC	100.1	626.1	307.3	437	347	203.8%
SOAPnet	BASIC	75.1	135.3	66.9	236	146	202.4%
CNBC	BASIC	98.2	352.6	234.1	156	166	150.6%
National Geographic Channel	BASIC	69.9	178.4	118.6	287	185	150.4%
TNT	BASIC	100.4	1,271.9	870.0	1,509	1,018	146.2%
FOX News	BASIC	98.9	827.0	622.2	1,432	899	132.9%
Disney XD	BASIC	77.9	124.9	94.6	221	192	132.0%
E! Entertainment Television	BASIC	97.9	246.9	202.0	463	319	122.2%
FX Network	BASIC	95.9	495.5	437.3	818	483	113.3%
AMC	BASIC	96.4	284.0	262.2	681	439	108.3%
Travel Channel	BASIC	95.6	123.2	121.3	331	217	101.6%
MSNBC	BASIC	95.2	187.5	187.6	557	319	99.9%
WE tv	BASIC	76.8	101.2	106.4	226	138	95.2%
WGN America	BASIC	72.7	142.2	149.9	226	214	94.9%
The Weather Channel	BASIC	100.6	141.2	158.3	181	213	89.2%
CMT	BASIC	91.9	98.2	117.3	250	180	83.7%
TBS	BASIC	101.0	621.1	754.7	1,197	676	82.3%
Discovery Channel	BASIC	100.5	409.8	503.9	798	492	81.3%
Spike TV	BASIC	99.5	253.2	317.4	600	427	79.8%

Notes: Total revenue is calculated as the sum of net advertising revenue and license fee revenue. Limited to networks with available license fee and net advertising revenue figures.
Source: © 2011 SNL Kagan, a division of SNL Financial LC -- downloaded June 21, 2012.

Table 1
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Limited to Networks With Total Revenue Greater Than or Equal to 200M

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TLC	BASIC	99.5	210.0	273.9	745	397	76.7%
Animal Planet	BASIC	97.1	109.3	143.7	403	284	76.1%
TV Land	BASIC	97.8	136.7	179.9	623	454	76.0%
History	BASIC	99.1	266.9	356.4	1,048	599	74.9%
A&E	BASIC	99.8	310.0	426.2	994	607	72.7%
USA	BASIC	100.0	684.5	955.1	2,144	1,116	71.7%
ABC Family Channel	BASIC	98.5	261.3	370.5	906	520	70.5%
Bravo	BASIC	93.9	218.5	321.1	571	299	68.0%
Syfy	BASIC	98.2	254.2	379.1	1,197	428	67.1%
Lifetime Television	BASIC	99.7	345.0	528.5	780	510	65.3%
Oxygen Network	BASIC	76.3	91.8	143.0	324	205	64.2%
VH1	BASIC	98.7	192.7	309.7	338	227	62.2%
BET	BASIC	90.7	185.6	324.6	520	373	57.2%
Cartoon Network	BASIC	99.3	216.7	390.6	129	862	55.5%
MTV	BASIC	99.2	414.6	755.4	659	413	54.9%
Nickelodeon/Nick At Nite	BASIC	100.3	566.7	1,098.1	1,537	1,576	51.6%
truTV	BASIC	92.6	111.6	234.3	725	524	47.7%
Comedy Central	BASIC	99.0	172.3	427.2	710	418	40.3%
Food Network	BASIC	100.2	177.8	481.7	758	516	36.9%
HGTV	BASIC	99.4	166.3	515.9	906	554	32.2%
Hallmark Channel	BASIC	87.3	60.8	199.5	648	389	30.5%

Notes: Total revenue is calculated as the sum of net advertising revenue and license fee revenue. Limited to networks with available license fee and net advertising revenue figures.
Source: © 2011 SNL Kagan, a division of SNL Financial LC -- downloaded June 21, 2012.

EXHIBIT A

CURRICULUM VITA OF PROFESSOR KEVIN M. MURPHY

Curriculum Vitae

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March 2012

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Current Positions

July 2005-Present: George J. Stigler Distinguished Service Professor of Economics, Department of Economics and Booth School of Business, University of Chicago

Faculty Research Associate, National Bureau of Economic Research

Education

University of California, Los Angeles, A.B., Economics, 1981

University of Chicago, Ph.D., 1986

Thesis Topic: *Specialization and Human Capital*

Previous Research and Academic Positions

2002-2005: George J. Stigler Professor of Economics, Department of Economics and Booth School of Business, University of Chicago

1993 – 2002: George Pratt Shultz Professor of Business Economics and Industrial Relations, University of Chicago

1989 – 1993: Professor of Business Economics and Industrial Relations, University of Chicago

1988 – 1989: Associate Professor of Business Economics and Industrial Relations, University of Chicago

1986 – 1988: Assistant Professor of Business Economics and Industrial Relations, University of Chicago

1983 – 1986: Lecturer, Booth School of Business, University of Chicago

1982 – 1983: Teaching Associate, Department of Economics, University of Chicago

1979 – 1981: Research Assistant, Unicon Research Corporation, Santa Monica, California

Honors and Awards

2008: John von Neumann Lecture Award, Rajk College, Corvinus University, Budapest

2007: Kenneth J. Arrow Award (with Robert H. Topel)

October 2005: Garfield Research Prize (with Robert H. Topel)

September 2005: MacArthur Foundation Fellow

1998: Elected to the American Academy of Arts & Sciences

1997: John Bates Clark Medalist

1993: Fellow of The Econometric Society

1989 – 1991: Sloan Foundation Fellowship, University of Chicago

1983 – 1984: Earhart Foundation Fellowship, University of Chicago

1981 – 1983: Fellowship, Friedman Fund, University of Chicago

1980 – 1981: Phi Beta Kappa, University of California, Los Angeles

1980 – 1981: Earhart Foundation Fellowship, University of California, Los Angeles

1979 – 1981: Department Scholar, Department of Economics, University of California, Los Angeles

Publications

Books

Social Economics: Market Behavior in a Social Environment with Gary S. Becker, Cambridge, MA: Harvard University Press (2000).

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"This Sin Tax is Win-Win," by Christopher Farrell. *Business Week*, April 11, 1994, pp. 30. Commentary section refers to Murphy, Becker, and Grossman's work on rational addiction.

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