

## 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.<sup>57</sup> Second, Comcast acquired control over the programming assets of NBC Universal, which had previously been non-cable affiliated.<sup>58</sup> 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.<sup>59</sup> 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.<sup>60</sup>

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

<sup>58</sup> See generally *Comcast/NBCU Order*.

<sup>59</sup> 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.

<sup>60</sup> *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.<sup>61</sup> 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.<sup>62</sup> Indeed, approximately 27 percent of the national video networks that comprise DIRECTV's most popular tier of service (Choice XTRA) are cable-affiliated.<sup>63</sup> 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.”<sup>64</sup>

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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<sup>61</sup> “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.

<sup>62</sup> *Notice*, Appendix B, Table 1.

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

<sup>64</sup> *2002 Extension Order*, ¶ 32.

any one network alone might not.<sup>65</sup> 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.”<sup>66</sup> While this is not a new phenomenon, it is one that the Commission did not previously consider in its extension analysis.<sup>67</sup>

***Regional Sports Networks.*** The Commission has identified RSN programming as critical to any MVPD offering.<sup>68</sup> 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%).<sup>69</sup>

***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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<sup>65</sup> 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”).

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

<sup>67</sup> 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.

<sup>68</sup> E.g., *2007 Extension Order*, ¶ 34.

<sup>69</sup> *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.<sup>70</sup> 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.<sup>71</sup>

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."<sup>72</sup> 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.<sup>73</sup> More likely yet is the possibility that that cable-

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<sup>70</sup> 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.").

<sup>71</sup> 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).

<sup>72</sup> *Comcast/NBCU Order*, ¶ 46.

<sup>73</sup> 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.aspx?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.<sup>74</sup> 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.<sup>75</sup>

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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.”<sup>76</sup>

### 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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<sup>74</sup> 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>).

<sup>75</sup> *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 . . . .”)).

<sup>76</sup> *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).<sup>77</sup> 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.<sup>78</sup> 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—

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<sup>77</sup> 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>.

<sup>78</sup> *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.<sup>79</sup> By comparison, average revenue per subscriber for DIRECTV and DISH Network (two video-only providers) was both much smaller and increased more slowly.<sup>80</sup>

MVPD	December 2006	December 2011	Change
Comcast <sup>81</sup>	\$95.00	\$137.00	44.2%
DIRECTV <sup>82</sup>	\$73.74	\$93.27	26.5%
DISH Network <sup>83</sup>	\$62.47	\$76.93	23.1%

Table 2. Comparison of Average Monthly Revenue Per Video Subscriber

<sup>79</sup> 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>).

<sup>80</sup> 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.

<sup>81</sup> 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>).

<sup>82</sup> 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](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>).

<sup>83</sup> 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),<sup>84</sup> 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).<sup>85</sup> 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

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<sup>84</sup> The lone exception is DIRECTV, which is subject to conditions that limit its ability to enter into exclusive arrangements with affiliated programmers.

<sup>85</sup> 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.<sup>86</sup> 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.<sup>87</sup> 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.<sup>88</sup> 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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<sup>86</sup> See *Notice*, ¶ 8 and n.28 (citing cases).

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

<sup>88</sup> *Comcast-NBCU Order*, Appendix B, ¶¶ 39-46.

builds upon the framework used to analyze the competitive effects of the Comcast/NBCU transaction.<sup>89</sup> 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.<sup>90</sup>

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<sup>89</sup> See Kevin M. Murphy, “Report of Professor Kevin M. Murphy” (June 22, 2012) (“Murphy Report”) (attached hereto as Exhibit A).

<sup>90</sup> *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.<sup>91</sup>

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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<sup>91</sup> *Id.* at 10-14.

Professor Murphy observes that MVPD exclusives, by contrast, nearly always *reduce* end-user access to the product.<sup>92</sup> 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.<sup>93</sup> 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.<sup>94</sup> 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.”<sup>95</sup> 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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<sup>92</sup> 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.

<sup>93</sup> *Id.* at 16-17.

<sup>94</sup> *Id.*

<sup>95</sup> *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.<sup>96</sup> 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.<sup>97</sup> 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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<sup>96</sup> *E.g.*, *Comcast/NBCU Order*, Appendix B, ¶¶ 7-9.

<sup>97</sup> Murphy Report at 24-25.

affiliated programmers do not.<sup>98</sup> 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.<sup>99</sup>

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.<sup>100</sup> 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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<sup>98</sup> *Id.* at 22-25.

<sup>99</sup> *Id.* at 25-26.

<sup>100</sup> *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.<sup>101</sup>

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.<sup>102</sup>

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.<sup>103</sup>

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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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<sup>101</sup> *Id.* at 31-32.

<sup>102</sup> *Id.* at 28.

<sup>103</sup> *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.<sup>104</sup> 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

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<sup>104</sup> *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.<sup>105</sup> 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.<sup>106</sup> 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

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<sup>105</sup> See *Notice*, Appendix B, Table 2 (listing networks).

<sup>106</sup> 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.”<sup>107</sup> This would cause a separate set of problems.<sup>108</sup>

#### **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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<sup>107</sup> *2007 Extension Order*, ¶ 72.

<sup>108</sup> 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.<sup>109</sup> 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.<sup>110</sup> 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.”<sup>111</sup>

To take perhaps the most obvious example, national sports networks have many characteristics in common with regional ones. Both contain programming 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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<sup>109</sup> Notice, ¶ 72.

<sup>110</sup> 2007 Extension Order, ¶ 69. See also 2002 Extension Order, ¶ 69 (same).

<sup>111</sup> See 2007 Extension Order, ¶ 39.

significantly hinder an MVPD from competing in the marketplace.”<sup>112</sup> MVPDs would have a very difficult time competing without providing the wide array of professional and major college sports available on ESPN,<sup>113</sup> 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.”<sup>114</sup> Rather, all “cable programming is highly differentiated, so the foreclosed rivals cannot practically or inexpensively avoid the harm by substituting other programming.”<sup>115</sup> 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.<sup>116</sup>

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<sup>112</sup> *AT&T HD Access Order*, ¶30 (citing *2010 Program Access Order*, ¶ 9).

<sup>113</sup> 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/>).

<sup>114</sup> *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)”).

<sup>115</sup> *Comcast/NBCU Order*, ¶ 37 n.90.

<sup>116</sup> 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”<sup>117</sup> 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.<sup>118</sup> 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

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<sup>117</sup> *Cablevision I*, 597 F.3d at 1315.

<sup>118</sup> 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.<sup>119</sup> 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)."<sup>120</sup>

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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<sup>119</sup> *Notice*, ¶ 47.

<sup>120</sup> *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.<sup>121</sup>

*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.”<sup>122</sup>

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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<sup>121</sup> 47 U.S.C. § 548(b); 47 C.F.R. § 76.1001(a). This statutory provision does not include a sunset provision.

<sup>122</sup> *Verizon HD Access Review Order*, ¶ 4. See also *AT&T HD Access Review Order*, ¶ 4 (same).

lengths to address this harm.<sup>123</sup> 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.<sup>124</sup> 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.”<sup>125</sup> 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.<sup>126</sup> 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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<sup>123</sup> See Sections I-II, above.

<sup>124</sup> Notice, ¶¶ 53-54.

<sup>125</sup> *2010 Program Access Order*, ¶ 26.

<sup>126</sup> See Section II.B.2, above.

proceedings.<sup>127</sup> 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.<sup>128</sup> 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.”<sup>129</sup> 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.<sup>130</sup>

**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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<sup>127</sup> *Notice*, ¶ 55.

<sup>128</sup> *Id.*, ¶ 56.

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

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