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December 13, 2013

<u>FILED IN DOCKET 10-71 THROUGH ECFS</u>
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<u>White & Wheeler On Economics</u>

Walter White, the antihero in the TV series *Breaking Bad*, once recommended to his associates in the crystal meth business this road to riches: "Corner the market, then raise the price."

"Simple economics" was what he correctly called this prescription. One does not need to be a rocket scientist, brain surgeon, economics professor or even high school chemistry teacher to understand that an unregulated market with a single supplier and multiple competitive buyers will not produce socially optimal results.

Unfortunately, when it comes to the market for retransmission consent, the Commission, under prior Chairmen, has ignored this economic truism.

For example, Sherrese Smith, a senior advisor to former Chairman Genachowski, reportedly once explained the Commission's passivity in the face of station blackouts during retransmission consent renewal negotiations by saying that "[w]e see this as a market situation."[1] During the CBS/Time Warner Cable blackout, a Wells Fargo analyst, Marci Ryvicker, reported that her contacts were saying that the Commission preferred that retrans "remain a market-based regime."[2] We have heard similar sentiments expressed by others at the Commission.

Clearly, some at the Commission have subscribed to the notion that the public interest is best served by leaving correction of whatever problems may be associated with retransmission consent to blind market forces, rather than principled and intelligent intervention by the government agency charged with oversight of that market.

That choice might well make sense in the case of a competitive market. According to classical economic theory, competitive markets produce optimal results for society. Consumers get the goods and services they want in the quantities they desire and at the lowest prices consistent with producers earning sufficient returns to stay in business. If, occasionally, the market goes off course, the "invisible hand" will right the ship.

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[1] J. Flint, *FCC not likely to wade into fee battles between broadcasters and cable providers,* L.A. Times (May 13, 2010), http://articles.latimes.com/2010/may/13/business/la-fi-ct-fcc-20100513.

[2] D. Goetzl, *Analyst: FCC Won't Get Involved With TWC-CBS Battle,* MediaDailyNews (Aug. 15, 2013), http://www.mediapost.com/publications/article/206909/?print.

Not all markets are competitive, however. When they are not, "market failure" can occur. One or a few sellers can "corner the market," causing higher prices and economic inefficiency, to the detriment of consumers and society as a whole.

If a competitive market exists and is working to maximize social surplus, government intervention is not needed—indeed, it could be harmful because of the potential for upsetting competitive equilibrium and thereby lowering surplus. If there is a market failure, however, the market will not self-correct and government intervention may be beneficial.

As the National Association of Broadcasters said in a recent advertisement: "When the free market works, viewers win."[3] Much to our surprise, NAB has said something that we can agree with. As usual, however, it has not told the whole story. It ignored the fact that the market for retransmission consent is "a far cry from the free market," as the President and CEO of the American Cable Association said a few days ago,[4] and neglected to mention that when a market is not competitive, consumers lose.

It would be apparent to Walter White, and even some of his high school students, that despite the sloganeering of broadcast interests about the "free market," the marketplace for retransmission consent has never been a competitive market because it lacks at least one essential prerequisite: multiple producers who sell undifferentiated products that are perfect substitutes for each other.

In 1992, when the retransmission consent requirement was created, the market took the form referred to by economists as a bilateral monopoly,[5] consisting within any given DMA, of a single "monopoly" seller (a station broadcasting "must-have" programming[6] and enjoying advantages such as territorial and programming exclusivity conferred or enforced by the FCC[7]) and a single "monopoly" buyer or monopsony (the cable company), instead of multiple buyers and sellers as in a classic competitive market or even a few buyers and a few sellers, as in a so-called "bilateral oligopoly." In a market with a single seller, abuses of market power can be prevented or ameliorated if there is a single buyer with countervailing monopoly power, and vice versa.[8]

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[3]Quoted in J. Eggerton. *NAB on Retrans: There's "Snow" Problem,* Broadcasting & Cable (Dec. 12, 2013).

[4] M. Polka, *Retransmission consent regulation: A far cry from the free market,* The Hill (Dec. 10, 2013), http://thehill.com/blogs/congress-blog/technology/192556-retransmission-consent-regulation-a-far-cry-from-the-free.

[5] In a bilateral monopoly, "an upstream monopolist sells its output to a single downstream buyer who may also a monopolist in its output market." R. Blair, D. Kaserman & R. Romano, *A Pedagogical Treatment of Bilateral Monopoly,* 55 Southern Econ. J. 831 (1989).

[6] The fact that some programs carried by big-four network affiliates have few, if any, close substitutes in the eyes of a significant number of viewers allows station owners to extract retrans fees that exceed competitive rates. *See* C. Goldfarb Congressional Research Service, *Retransmission Consent and Other Federal Rules Affecting Programmer-Distributor Negotiations: Issues for Congress* (July 9, 2007) ("*CRS Report*"). *Cf* C. Yoo, *Rethinking the Commitment to Free, Local Television,* 52 Emory L.J. 1579, 1588 (Fall 2003). .

[7] For some of the government-conferred or -protected rights of television stations that skew the market, see M. Polka, *Retransmission consent regulation: A far cry from the free market, supra,* note 4.

[8] This does not mean, however, that the buyer and seller have equal market power in a bilateral monopoly. They may have disproportionate bargaining power because of other factors.

The emergence of strong competition to cable companies after 1992 destroyed bilateralism, but it did not make the market a competitive one. On the supply side, broadcasters continue to be virtual monopolists with regard to programs that engender intense viewer loyalty, but on the demand side, the monopoly buyer has been replaced by an oligopoly of competitive distributors. As noted in a 2007 report by the Congressional Research Service:

> [S]tructural market changes . . . have given programmers with "must-have" programming much greater leverage, particularly when they are negotiating with small distributors. Competitive entry in distribution—almost all cable companies now face competition from two satellite companies, and are beginning to face competition from telephone companies—has emboldened programmers with popular programming. . . . Thus, ironically, competition in the distribution market may be resulting in higher programming costs that MVPDs may have to pass on to their subscribers.[9]

Empirical evidence supports what theory and logic tell us. Since 2006, retransmission consent costs have grown from virtually zero to an estimated $3 billion a year. Those increases will continue and accelerate. SNL Kagan predicts that retrans fees will reach $6 billion annually in a few years, and that estimate is far too low. CBS has announced as its goal the quadrupling of its revenue based on retransmission consent by 2016 or 2017, from $250 million to $ 1 billion. No doubt the other broadcast station owners will follow its lead, meaning that the $3 billion a year currently collected could possibly increase to $12 billion, all of which ultimately comes from consumers' pockets.

In short, the price for retransmission consent keeps rising at extraordinary rates. These remarkable increases are happening despite the continuing migration of sports and other popular programming from broadcast channels to pay networks, declines in broadcast television viewership, the consolidation of news operations and the absence of meaningful locally produced programs other than news and morning shows.

Similarly, when broadcasters resort to shutoffs as a bargaining tactic (as they have done many times this year alone), the blackout ends, in just about every single case of which we are aware, with the distributor paying higher retrans fees. The shutoff rarely, if ever, concludes with the broadcaster agreeing to reduce or even maintain its price.

Indeed, broadcasters are immune to the price discipline ordinarily imposed by consumers in a truly competitive market. MVPD subscribers are the ones who ultimately pay for retransmission consent. Commission rules and television programming owners' practices force distributors to offer, and subscribers to buy, programming in bundles over which distributors have little or no control. The result is to all but eliminate consumers' ability to influence supplier pricing and behavior.

Most subscribers do not know their cost of watching network programs on a local station because of confidentiality restrictions imposed by station owners. If they learn the cost and think that it is too high, they do not have the option of foregoing further purchases of just that station. The Commission rules and the contractual requirements station owners impose on MVPDs mean that the only option available to subscribers who believe that a local station is overpriced is to cancel their entire subscription and lose access to their favorite non-broadcast networks. At the same time, distributors are prevented from packaging their video offerings in ways that give consumers more choice and, therefore, greater ability to provide content owners with pricing feedback that has bite.

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[9] *CRS Report*, *supra*, note 6.

As Walter White probably could have told us, the fact that prices only go up, are unresponsive to declines in demand and other events that normally drive prices down in competitive markets and are incapable of being influenced by choices made by consumers is strong evidence that the retrans market has been successfully cornered.

Inexplicably, even though economic theory and empirical evidence literally shout "market failure," the Commission has chosen to continue reliance on blind market forces rather than give intelligent regulation a try. Unfortunately, in the retrans market, the self-correcting "hand" cannot be seen not because it is invisible, but because it is not there. As economic theory predicts and materials filed in this Docket demonstrate, the results of taking a laissez-faire regulatory approach to an uncompetitive market have been bad for consumers and society and are directly contrary to Congress's intent in creating the retransmission consent right.[10]

After years of frustration because of the Commission's dogged adherence to the belief that an unregulated market with a virtual monopolist as seller and fierce competitors as buyers will produce good results for consumers, it has been refreshing to read Chairman Wheeler's recent comments indicating that the Commission, under his leadership, may take a much more sensible approach. In a speech recently delivered at Ohio State University,[11] the Chairman noted that while he is a "rabid believer in the power of the marketplace," he knows that markets "don't always, by themselves, solve every problem." Moreover, he expressed support for a "see-saw rule" under which "when competition is high, regulation can be low." Obviously, the corollary of that proposition is that when competition is low—as it is on the seller side of the retrans market—the Commission needs to take a more active role.

Although encouraged by these sentiments, we are concerned that the Commission may continue to ignore the retrans marketplace because of the seductive appeal of the issues associated with hipper and more cutting-edge technologies and communications services. Television, after all, is widely believed to be akin to a dinosaur grazing as the giant asteroid speeds ever closer to impact. Here today, gone tomorrow, and so why waste scarce agency resources?[12]

That would be unfortunate. Right now, and for the foreseeable future, watching programming delivered by MVPDs over plain-old-television-sets is and will remain a major part of the daily experiences of the vast majority of Americans. Roughly 100 million households subscribe to an MVPD service, and, on average, they spend more money each month for video service than for broadband or smartphone service. As the title of an August 29th article by Jeff Baumgartner in *Multichannel News* said, "Linear TV Viewing Still Matters."

Continuing to allow "market forces" free reign in an uncompetitive market dominated by a handful of companies that control dozens of stations, each of which enjoys a government-protected local monopoly over popular programming for which there is no close substitute, will wind up needlessly costing a hundred million households billions of dollars.

In his speech at Ohio State University, Chairman Wheeler, said that "[t]he public has the right to be represented as we go through the transition that is the fourth network revolution." We respectfully submit that, until the revolution finally overthrows the ancien régime of linear programming delivered through a set-top box, someone also needs to be looking out for the public interest in the realm of

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[10] *See, e.g.*, 138 Cong. Rec. S14602 (Sept. 22, 1992) (statement of Sen. Bradley) (a "rate increase resulting from these [retransmission consent and buy-through] provisions would turn the purpose of this bill on its head").

[11] Available at http://www.fcc.gov/document/remarks-fcc-chairman-tom-wheeler-ohio-state-university.

[12] "Limited resources" was one of the reasons cited by Ms. Ryvicker's sources for the Commission's preference for leaving retrans to market forces referred to above.

retransmission consent. It is clear from the legislative history of the 1992 Cable Act that Congress intended for the Commission to fill that role, giving it both the duty and authority to intervene in the market if the exercise of the retransmission consent right produced higher prices and service interruptions. The Commission's restrictive view of its responsibility and power is simply wrong, for reasons discussed at length in the filings made by Mediacom and others in the pending retransmission consent proceeding.

The docket in that moribund proceeding contains a wealth of information regarding both the Commission's authority to address the problems resulting from the flawed retrans market as well as recommendations of specific corrective actions that might be taken. We respectfully urge the Commission to dust off that docket, invite interested parties to update their submissions and undertake a comprehensive re-evaluation of its regulatory posture with an open mind and from the perspective of protecting consumers and discharging its mandate to advance the public interest, rather than continuing to take the easy path of deferring to market forces that, as Walter White could have predicted in light of the nature of the market, have produced nothing but ever-rising prices and service disruptions for millions of Americans.

Thank you for your time and consideration.

Very truly yours,

Joseph E. Young

cc: Maria Kirby
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