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MEDIA OWNERSHIP

HEARING

BEFORE THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

ONE HUNDRED EIGHTH CONGRESS

FIRST SESSION

MAY 6, 2003

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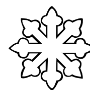

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SENATE COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION

ONE HUNDRED EIGHTH CONGRESS

FIRST SESSION

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MEDIA OWNERSHIP

TUESDAY, MAY 6, 2003

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The Committee met, pursuant to notice, at 9:33 a.m. in room SR–253, Russell Senate Office Building, Hon. John McCain, Chairman of the Committee, presiding.

OPENING STATEMENT OF HON. JOHN McCAIN, U.S. SENATOR FROM ARIZONA

The CHAIRMAN. Good morning. Today we will be examining media ownership. In particular, we will examine competition in the market for video programming and distribution.

Cable companies remain the dominant providers of subscription-video services. According to the Federal Communications Commission, these companies have more than 75 percent of the market for delivering programming to consumers. Satellite companies and others have made some inroads over the past decade, but the market still belongs to cable.

Consolidation in the market has resulted in a few very large cable companies with the lion's share of the subscribers. Likewise, a few content companies, including cable operators and broadcast networks, own a substantial number of cable channels. I do not subscribe to the notion that big is always bad in a corporate environment, but along the way to significant consolidation in the cable industry we have seen a pattern of annual rate increases imposed on consumers that greatly outpace the rate of inflation. Since 1996, cable rates have increased 50 percent, almost three times the rate of inflation.

In its annual report on cable rates, the FCC last year found that, "The overall average monthly rate for cable programming, services, and equipment increased by 7.5 percent for the 12-month period ending July 1st, 2001." The FCC is expected to release its next report any day now, but given the announcement of 6 to 7 percent increases by many of the largest cable companies, I do not expect much to change.

Perennial price hikes are not the hallmarks of a competitive industry. In fact, the FCC report suggests that cable operators that face effective competition offer rates that are more than 6 percent lower than those companies that do not face effective competition. A subsequent GAO study suggests that even this number may be too conservative.

Last year, the GAO found that, "in franchise areas with a second cable provider, cable prices are 17 percent lower than in comparable areas without a second cable provider." Clearly, competition affects rates, but most cable companies face little competition.

That is why I was disappointed last year when the FCC rejected the proposed merger of EchoStar and DirecTV. I thought the combined company would have been a better competitor to cable. Recently, Rupert Murdoch's News Corporation entered an agreement to acquire a significant interest in DirecTV. If approved, the combined company will control a multinational satellite distribution system, multiple film and television studios, several Major League sports teams, a national television broadcast network, more than 30 broadcast television stations, the most watched cable news channel, a national sports programming network, including multiple regional sports networks, multiple other cable channels, the national broadcast rights to Major League Baseball, half of the NASCAR racing season, every third Super Bowl, regional rights to 67 of 80 teams in the NBA, NHL, and Major League Baseball, and significant publishing outlets. I think the latest proposal raises interesting questions that I hope to discuss today.

A common refrain from cable companies is that rate increases are largely attributable to the cost of programming, especially sports programming. Last week, the *Wall Street Journal* reported, "Some events always cause pain, like going to the dentist and paying taxes. For cable and satellite operators, the event is the annual rate increase notice from Walt Disney Company's popular ESPN sports network. Last Wednesday, ESPN once again delivered the bad news to operators, informing them of a 20 percent increase August 1st on a rate that is already one of the highest in the cable industry."

I am told that ESPN has provided proposals to cable companies indicating that the charge per subscriber in 2012 could be as high as $14 per month. While not the only cause of cable rate increases, soaring sports programming costs passed along to all expanded basic-cable subscribers certainly appear to play a role. I fail to understand why any customer should be forced to pay for programming they do not want.

I look forward to hearing the thoughts of our witnesses on the merits of a la carte pricing or tiering of cable channels to give consumers more control over their cable bill. I thank our witnesses for being here today.

Senator Stevens?

STATEMENT OF HON. TED STEVENS, U.S. SENATOR FROM ALASKA

Senator STEVENS. Mr. Chairman, I congratulate you on this hearing. I hope it is going to be "hearings" before we are through. But I do think we need to review what is going on in the cable industry and its relationship to the new concepts that you have mentioned with regard to direct service and Murdoch's new system.

But I am also concerned about the new concepts of cable going into long-distance telephone service. They have refused to make any contribution to Universal Service fees, and there are other

problems facing us now with respect to the ownership caps. I hope we will get into that, also.

I oppose raising the cap above 35 percent to allow networks to buy up independent affiliates, but we have got some real problems about cross-ownership restrictions between newspapers and broadcasters. The whole subject needs a real series of hearings, I believe, and I hope you will be willing to get into those.

I do not want to take a lot of time right now, but I do think that if these cable systems can be used to network long distance to avoid the Universal Service Fund, it is going to really destroy the whole concept of Universal Service before we are through. And I look forward to perhaps initiating the concept of having an Omnibus bill dealing with problems to telecommunications before this Congress is over.

So I commend you for initiating this. I hope it is an "initiating," Mr. Chairman, and we should spend a lot of time on this in this Congress.

Thank you.

The CHAIRMAN. Thank you, Senator Stevens.

Senator Wyden?

STATEMENT OF HON. RON WYDEN, U.S. SENATOR FROM OREGON

Senator WYDEN. Thank you very much, Mr. Chairman. I am very pleased you are holding this hearing, because, obviously, in a lot of communities cable rates have soared through the stratosphere, and there are important issues we ought to be looking at.

I am particularly interested in examining three. The first deals with this matter of a la carte pricing. I mean, the average consumer simply wants a modest meal at a reasonable price. But, instead, as a result of the way these deals are structured, the consumer is being force fed a whole five-course feast and basically gets stuck with the bill. And the reality is a lot of senior citizens want, for example, a few channels, and they end up getting shellacked with a huge bill paying for a sports star to get a multimillion-dollar contract and maybe ends up playing in the minors, and the consumer gets the bill. So I think it is important we look at the a la carte pricing issue, and I am glad you are doing that.

The second issue, of course, Mr. Chairman, is this question of media concentration, which I think is very troubling, because my sense is a few large companies are effectively going to become gatekeepers for content, making it almost impossible for independent programming to get carried. And the problem is really compounded. In my home State of Oregon, what you have had there is the small cable companies find that to get a channel they know their subscribers really want, they have to agree to take a bunch of additional channels, as well, because the same media conglomerate owns multiple stations and wants them all carried. So the local cable systems cannot select just the channels they want for their system; they are forced to buy things they do not want.

So my sense is that there may be a new coalition in this country, and that is the consumer and many of the small cable companies going up against these media conglomerates who can own program

channels and distribution channels and basically hammer anybody who gets in the way.

So I am pleased you are holding this hearing and look forward to examining those three issues, in particular.

The CHAIRMAN. Thank you.

Senator Burns?

STATEMENT OF HON. CONRAD BURNS, U.S. SENATOR FROM MONTANA

Senator BURNS. Thank you, Mr. Chairman, and thanks for holding this hearing. And you are doing exactly what we should be doing in oversight, and I congratulate you for that. I think it is very timely.

I am going to submit my statement, Mr. Chairman. We want to hear from the witnesses this morning, in the absence of time. I do want to make a couple of points, though.

I think we do have a competitive landscape out there. There is no doubt about that. In programming, maybe we should take some time to look at that. I want to ask some questions about a la carte. I am concerned about that. The only reason I want the style section in the *Washington Post* is because that is where the crossword puzzle is. If they would relocate that, well, maybe I would want to buy the *Washington Post* a la carte, but I do not think that is going to happen.

And with regard to what Senator Stevens, what he brought up, on Universal Service and the addition of new services on cable, we are very supportive of that, but also we will be hosting a summit between the FCC and the Joint Board and Members of Congress and some of the industry to a summit coming up. We do not have all of it put together yet, Mr. Chairman, and I think we should get a roundtable and find out exactly the direction we should be going, as far as Universal Service is concerned. And it would entail all of the Commerce Committee, and we hope that maybe we would bring some facts to life in how to fix this thing. But we are all going to have to work together in order to get it done.

And thanks, again, for holding this hearing.

[The prepared statement of Senator Burns follows:]

PREPARED STATEMENT OF HON. CONRAD BURNS, U.S. SENATOR FROM MONTANA

Mr. Chairman, thank you for calling for this hearing in what I understand is to be the second in a series of hearings on media ownership. Today's focus will be on the state of competition in the cable marketplace.

Fortunately, we do have competition in multichannel video services in Montana. A decade ago if you had problems with your cable service, you didn't have a good alternative. This is not the case today, however. EchoStar and DirecTV offer 500 channels of digital video and CD quality music. In fact, close to 40 percent of Montana households subscribe to a direct broadcast satellite service. Even though cable doesn't reach every household in Montana, where cable is deployed, it competes head to head with satellite providers.

The market discipline imposed by competition is far more effective in protecting consumers than any government regulation. Competition forces companies to innovate in order to keep their customers and attract new ones. That's just what the cable industry has done, investing billions to upgrade its systems in order to offer new services like high speed Internet access.

One of my top priorities is making certain every household and business in Montana has access to high speed Internet service. In many cases, rural communities are not seeing the tremendous benefits of the wonders of the digital age. We must

make certain that everyone in rural America has access to the same digital services enjoyed by those who live in urban areas. We can't effectively grow our economy, create new jobs, guarantee access to advanced health care services and provide new educational opportunities to our children until we make sure high speed Internet access is available across this nation.

Ensuring access to broadband service is not a one-technology solution in a rural, mountainous state like Montana. Cable, telephone companies, satellites and new wireless technologies will all play a role in making sure that broadband is available everywhere and that people have a choice of providers.

In allowing the full array of broadband delivery mechanisms to be made available to rural consumers, we must be more aware than ever of the true costs of regulation. We all know how regulation impacts the ability of an industry to raise money and invest in the future. Just look at what happened when Congress regulated the cable industry a decade ago. The industry could not obtain the capital necessary to invest in new programming or create new services. It wasn't until the deregulation provided by the 1996 Telecommunications Act that cable was able to raise capital and begin to deploy new advanced digital services.

Finally, I wish to specifically address the issue of a la carte pricing. I have serious reservations about imposing such a system on cable operators. While as a consumer, it would be wonderful to choose and pay for only a favorite section of a newspaper, for instance, this type of system would have many unanticipated damaging effects. To continue the analogy, newspapers rely on different content to attract the broadest audience possible so as to maximize advertising revenue. If newspapers were required to separate the "Style" section from the "Business" section, the cost of content would simply spike upward because of the fracturing of the core audience into niches. In a similar fashion, by potentially increasing the price consumers have to pay to individual channels on television, an a la carte cable-pricing system would be a disservice to millions of cable subscribers throughout this country.

Competition is working to the benefit of Montana consumers, and consumers across the country. I hope this Committee does not stifle investment in new advanced services, like high speed Internet, by imposing new unneeded government regulation. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Lautenberg?

STATEMENT OF HON. FRANK LAUTENBERG, U.S. SENATOR FROM NEW JERSEY

Senator LAUTENBERG. Mr. Chairman, I would join my colleagues in congratulating you for holding this hearing. The subject is one that almost pervades our telephone calls and visits from constituents, and with good reason, because cable has become almost a commodity for people. And when you look at the rate increases between 1996 and 2002, cable rates increased by 45 percent.

Now, I am sure we are going to hear discussions about what constitutes basic programming and what constitutes expanded programming. And expanded programming, of course, is adding the costs for other services, but it does not mean that the basic cable operator does not have an opportunity to increase their revenues and, likely, their profits.

So I want to submit my statement for the record, Mr. Chairman, but I do want to add one thing, and that is the pending merger, in particular, that needs scrutiny, and that is News Corporation's acquisition of the controlling interest in DirecTV. Now, on its face, it may appear to be fostering competition, since DirecTV, a direct-broadcast satellite service, is compared to cable, but the media empire, News Corporation, what that chairman, Rupert Murdoch, has put together, is already quite extensive.

In the New York area, for instance, it includes two VHF broadcast stations, a daily newspaper, a broadcast network, a movie studio, a satellite service, and four cable networks. And by gaining

control of the DirecTV platform, they would have considerable leverage to extract higher licensing fees, which would drive subscriber costs up. And such concentration in the media also raises concern about the ability of people to have access to fair and balanced news coverage.

The issues are complicated, the stakes are enormous. The Committee, Mr. Chairman, has much work to do to start out. And, once again, I commend you for getting us started, and I look forward to hearing from our witnesses.

[The prepared statement of Senator Lautenberg follows:]

PREPARED STATEMENT OF HON. FRANK LAUTENBERG, U.S. SENATOR FROM NEW JERSEY

Mr. Chairman,

I congratulate you for holding this hearing on cable rates, the effect of mergers on competition in the cable and satellite TV industry, and related issues.

Cable Rates

There are very few issues that can compete with consumer concern over cable rates in terms of generating constituent mail and phone calls!

I'm sure that every Member of this Committee has heard from thousands of constituents who are—pardon the pun—*irate* about their rates. And with good reason: between 1996 and 2002, cable rates *increased by 45 percent*. That's nearly three times the rate of inflation.

We will hear testimony from cable operators that *part* of the increase is attributable to $70 billion in capital investments which are providing subscribers with greatly enhanced services.

Cable operators will also tell us that *much* of the increase is due to exploding costs for so-called "Expanded Basic" programming and that they have little leverage to influence such costs because of government-mandated "must buy" and "retransmission consent" provisions.

Programmers, on the other hand, will argue that so-called a la carte pricing would be bad for consumers. And they will argue that sports channels like ESPN serve as the "anchor store in the mall" and make it possible for niche channels to survive.

Because the Federal Communications Commission (FCC) has authority to regulate the rates for such programming, and because Congress has oversight responsibility, we are going to have to referee this dispute that goes to the heart of what our constituents are complaining about.

Concentration in the Industry

I'm concerned about industry mergers and their effect on competition. In just one year—between July 2001 and June 2002—there were 28 transactions, including the biggest and third biggest cable operators, AT&T and Comcast.

Now, the ten largest operators serve 85 percent of all cable subscribers. Not surprisingly, where there is competition, prices are lower. But in too many markets, there is little or no competition, and consumers suffer as a result.

News Corporation's Acquisition of DirecTV

There is one pending merger in particular that needs scrutiny: that's the News Corporation's acquisition of a controlling interest in DirecTV. On its face, it might appear to be fostering competition since DirecTV, which is a Direct Broadcast Satellite (DBS) service that competes with cable.

But the media empire News Corp. chairman Rupert Murdoch has put together is already quite extensive. In the New York metropolitan area, for instance, it includes two VHF broadcast stations, a daily newspaper, a broadcast network, a movie studio, a satellite service, and four cable networks. By gaining control of the DirecTV platform, Mr. Murdoch would have considerable leverage to extract higher licensing fees, which would drive subscriber costs up. Such concentration in the media also raises concern about the ability of people to have access to *fair and balanced* news coverage.

Conclusion

These issues are complicated and the stakes are enormous. The Committee has much work to do to sort out and evaluate competing claims and interests on behalf

of our constituents. Today, we're starting that process and I look forward to hearing from our witnesses.

The CHAIRMAN. Senator Smith?

STATEMENT OF HON. GORDON SMITH, U.S. SENATOR FROM OREGON

Senator SMITH. Thank you, Mr. Chairman, for holding this hearing. I am pleased to note that in spite of the downturn in the telecommunications market, the cable industry continues to invest in broadband facilities and the deployment of advanced services to consumers. And, particularly, they are doing this not just in urban areas, but also in rural areas. I believe this is happening, in part, because of increased competition and deployment of advanced services by satellite and telephone companies, as well.

On another note, as the Committee continues to deal with broadband and open competition in the media market, I want to express my support for maintaining the open nature of the Internet. We need to continue to keep the broadband market open and assure that customers continue to have access to content and the applications of their choice on a nondiscriminatory basis.

So I look forward, Mr. Chairman, to hearing our witnesses today. Thank you.

The CHAIRMAN. Senator Nelson?

STATEMENT OF HON. BILL NELSON, U.S. SENATOR FROM FLORIDA

Senator NELSON. Thank you, Mr. Chairman.

Mr. Chairman, we have had several hearings to find ways to stimulate investment in broadband, yet cable has gone ahead, without government incentives, to make broadband investments that have benefited consumers. We ought to take a close look at the cable rates. We need to make sure consumers are getting their money's worth, but we need to look at what the industry is now offering consumers and determine if the services fit the cost structure.

And, finally, Mr. Chairman, programming costs are only part of the reason cable rates have gone up. Their $70 billion network investment, a good investment for consumers, is also reflected in the retail rates.

So I am looking forward to your hearing, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Nelson.

Senator Lott?

STATEMENT OF HON. TRENT LOTT, U.S. SENATOR FROM MISSISSIPPI

Senator LOTT. Mr. Chairman, I would like to hear the witnesses. I have a statement that I would like to have included in the record, please.

The CHAIRMAN. Without objection, thank you.

[The prepared statement of Senator Lott follows:]

PREPARED STATEMENT OF HON. TRENT LOTT, U.S. SENATOR FROM MISSISSIPPI

Mr. Chairman, thank you for holding this important hearing today on media ownership issues in the video programming and distribution markets. Media ownership issues are a key area of jurisdiction for this Committee, and I am pleased that we are taking the time to carefully review these matters to insure that the American people are well-served by the media marketplace. Cable and direct broadcast satellite offer the American people the opportunity to receive a multitude of programs and services in their homes. It is positive to see that there are an increasing number of options and offerings for consumers in the video programming and distribution markets, and I am interested in hearing more details about the current state of the industry from the witnesses today.

While there are positive developments in this industry, there are also some aspects of the industry which this Committee needs to consider more closely. I hope that the testimony today will bring a greater understanding of the current challenges and successes in the cable and satellite industries, and I am happy that the Committee is devoting this time today for a thoughtful and careful look at this sector of the media marketplace.

The CHAIRMAN. Our first witness is Mr. William Shear, of the General Accounting Office.

Mr. Shear, you are accompanied by Ms. Abramowitz. Is that correct?

Mr. SHEAR. Yes.

The CHAIRMAN. All right.

Welcome, Mr. Shear. Please proceed with your opening statement, and thank you for your appearance before the Committee.

STATEMENT OF WILLIAM B. SHEAR, ACTING DIRECTOR, PHYSICAL INFRASTRUCTURE, U.S. GENERAL ACCOUNTING OFFICE; ACCOMPANIED BY AMY ABRAMOWITZ, ASSISTANT DIRECTOR

Mr. SHEAR. Mr. Chairman, Members of the Committee, I am pleased to be here this morning before you to discuss preliminary observations from GAO's work on cable television rates.

At this Committee's request, we examined, first, the reliability of information that cable companies provide to the FCC about cost factors underlying cable rate increases. And, second, we examined the FCC's process to update and revise how cable franchises are classified, in terms of whether they face effective competition, a statutorily defined term.

To address the reliability of information that the FCC collected, we randomly sampled 100 cable franchises that responded to the FCC's 2002 annual cable-rate survey. To examine the FCC's process for classifying cable franchises as to whether they face effective competition, we reviewed whether these classifications continue to accurately reflect current circumstances.

There are four tests of finding out effective competition in a franchise area—the low-penetration test, when few households in a franchise area subscribe to cable service; the competitive provider test, when two companies provide video service; the municipal test, when a government authority offers video-programming service; and the local-exchange carrier test, when a local telephone company provides video service.

Our preliminary analysis suggests that some of the FCC's information on cable companies is inconsistent and potentially misleading. In particular, our analysis indicates that FCC's survey

does not provide a reliable source of information on the cost factors underlying cable rate increases.

We have found two key causes of variation in how companies completed the survey. First, the FCC provided minimal instructions or examples on how the portion of the survey covering the cost factors underlying rate increases should be completed. As a result, we found that cable companies made varying assumptions about how to complete the survey. For example, 83 of the 100 franchises we surveyed entered zero for infrastructure investments, even though 33 told us that there had, in fact, been additional costs for such upgrades that year.

Second, the FCC survey form requires that the dollar amounts reported for the factors that might underlie rate changes add up to the reported rate increase for the year. In the absence of guidance on how to achieve the requisite balance, cable companies approached the question in varying ways. In particular, most of the companies told us that they adjusted, thereby possibly misreporting, one of the five cost factors for the purpose of the required balancing.

With respect to our second objective, on competitive status, our preliminary findings show possible inaccuracies in FCC's current classification of cable franchises. We found that FCC's classification might not always reflect current conditions. We found instances where information in the survey responses of some franchises would suggest that the criteria for effective-competition finding that was made in the past might no longer be present. However, a finding of effective competition is only changed if a formal process is instituted. We found only two instances where a petition was filed that resulted in a reversal of an effective-competition finding.

We are conducting additional work on the issues discussed today, and a more complete analysis will be included in our final report to you, which we plan to issue in October. In addition to topics I discussed today, we will be providing a more comprehensive analysis of the factors underlying cable rate increases, the impact of competition on cable rates and service, and cable tiering issues.

Mr. Chairman, that concludes my oral summary. Amy and I would be happy to answer any questions.

[The prepared statement of Mr. Shear follows:]

PREPARED STATEMENT OF WILLIAM B. SHEAR, ACTING DIRECTOR, PHYSICAL INFRASTRUCTURE, U.S. GENERAL ACCOUNTING OFFICE

Mr. Chairman and Members of the Committee:

I am pleased to be here today to provide preliminary observations from our ongoing work on cable television rates. Over 65 percent of American households are currently cable television subscribers. As you have noted, Mr. Chairman, cable television rates have been rising faster than the rate of general inflation for many years. At the request of this Committee, we are providing preliminary observations today on two issues: (1) the reliability of the information that cable companies have provided to the Federal Communications Commission (FCC) in 2002 regarding the costs factors underlying their recent cable rate increases, and (2) FCC's process for updating and revising the classification of cable franchises as to whether they are facing *effective competition*—a statutorily-defined term. We plan to issue a report with our final analysis of these and other issues in October 2003.

To address the reliability of information that the FCC collected, we randomly sampled 100 of approximately 700 cable franchises that responded to the FCC's

2002 cable rate survey.[1] We selected a random sample of 100 cable franchises so that we could make estimates about the entire population of about 700 cable franchises that responded to the FCC. We asked these franchises a series of questions about how they completed a portion of the FCC's survey that asks about the cost factors underlying annual cable rate changes. To examine the FCC's process for classifying cable franchises as to whether they face effective competition, we reviewed how various franchises were classified according to the FCC's information and whether these classifications continue to accurately reflect current circumstances.

Our work has focused on examining whether the FCC's annual report on cable rates is providing reliable information on the causes of rate increases and the competitive status in video markets. In summary, our preliminary analysis suggests that some of the FCC's information on cable companies is inconsistent and potentially misleading. In particular:

- Our preliminary analysis of the responses provided by 100 cable franchises indicates that the FCC's 2002 survey does not provide a reliable source of information on the cost factors underlying cable rate increases. We found two key causes of variation in how companies completed the survey. First, the FCC provided minimal instructions or examples on how the portion of the survey covering the cost factors underlying rate increases should be completed. As a result, we found that cable companies made varying assumptions about how to complete the survey. Second, the FCC survey form requires that the reported dollar amounts reported for factors that might underlie rate changes—5 cost factors and a non-cost factor are included on the form—sum to the reported rate increase for the year. In the absence of guidance on how to achieve this requisite balance, cable companies approached the question in varying ways. In particular, most of the companies told us that they adjusted one of the 5 cost factors for the purpose of the required balancing, thereby misreporting actual cost changes that had occurred.
- Our preliminary findings show possible inaccuracies in the FCC's current classification of cable franchises regarding their *effective competition* status. We found indications that there are cases in which a finding of effective competition in a particular franchise area that might have existed in the past no longer seemed accurate. Nevertheless, the determination of effective competition remained in effect because the franchising authority had not filed a petition that would challenge that finding. In fact, we found that such petitions are rare.

Background

Cable television emerged in the late 1940s to fill a need for television service in areas with poor over-the-air reception, such as in mountainous or remote areas. By the late 1970s, cable began to compete more directly with free over-the-air television by providing new networks—available only on cable systems—such as HBO (introduced in 1972), Showtime (introduced in 1976), and ESPN (introduced in 1979). According to the FCC, cable's penetration rate—as a percent of television households—increased from 14 percent in 1975 to 24 percent in 1980 and to 65 percent by 2002. Cable television is by far the largest segment of the subscription video market, a market that includes cable television, satellite service (direct broadcast satellite (DBS) providers such as DirecTV), and other technologies that deliver video services to customers' homes.

Cable companies deliver video programming to customers through cable systems. These systems consist of *headends*—facilities where programming from broadcast and cable networks is aggregated—and *distribution facilities*—the wires that carry the programming from the headend to customers' homes. Depending on the size of the community, a single headend can serve multiple communities or several headends may be required to serve a single large community. At the community level, cable companies obtain a franchise license under agreed-upon terms and conditions from a franchising authority, such as a township or county. In some cases, state public service commissions are also involved in cable regulation.

During cable's early years, franchising authorities regulated many aspects of cable television service, including franchise terms and conditions and subscriber rates. In 1984, the Congress passed The Cable Communications Policy Act, which imposed

[1] FCC samples between 700 and 800 of the universe of roughly 10,000 cable systems using a stratified sampling approach based on the status of effective competition and the size of the cable operator.

some limitations on franchising authorities' regulation of rates.[2] However, 8 years later, in response to increasing rates, the Congress passed The Cable Television Consumer Protection and Competition Act of 1992. The 1992 Act required the FCC to establish regulations ensuring reasonable rates for *basic service*—the lowest level of cable service that includes the broadcast networks—unless a cable system has been found to be subject to effective competition, which the Act defined. The Act also gave the FCC authority to regulate any unreasonable rates for upper tiers (often referred to as *expanded-basic service*), which includes cable programming provided over and above that provided on the basic tier.[3] Expanded-basic service typically includes such popular cable networks as USA Network, ESPN, CNN, and so forth. In anticipation of growing competition from satellite and wire-based providers, the Telecommunications Act of 1996 phased out all regulation of expanded-basic service rates by March 31, 1999. However, franchising authorities retain the right to regulate basic cable rates in cases where no effective competition has been found to exist.

As required by the 1992 Act, the FCC annually reports on cable rates for systems found to have effective competition compared to systems without effective competition. To fulfill this mandate, the FCC annually surveys cable franchises regarding their cable rates. In 2002, the survey included questions about a range of cable issues including the percentage of subscribers purchasing non-video services and the specifics of the programming channels offered on each tier to better understand the cable industry.

Until recently, cable companies usually encountered limited competition in their franchise areas. Some franchise agreements were initially established on an exclusive basis, thereby preventing wire-based competition to the incumbent cable provider. In 1992, the Congress prohibited the awarding of exclusive franchises, and in 1996, the Congress took steps to allow telephone companies and electric companies to enter the video market. Still, only limited wire-based competition has emerged, in part because it takes large capital expenditures to construct a cable system. However, competition from DBS has grown rapidly in recent years. Initially unveiled in 1994, DBS served over 18 million American households by June 2002. Today, two of the five largest subscription video service providers are DirecTV and EchoStar, the two primary DBS companies.

In a recently released report, we found that competition in the subscription video market can have a significant impact on cable rates.[4] Using an econometric model, we found that franchise areas with a second wire-based video provider had rates approximately 17 percent lower than similar franchise areas without such a competitor.[5] We did not, however, find that competition from DBS providers is associated with lower cable prices, although we did find that where DBS companies provide local broadcast networks to their customers, cable companies provide more channels than in areas where DBS companies do not provide local broadcast channels. Moreover, we also found that DBS providers obtain a substantially higher level of subscribers in areas where they are providing local broadcast channels.

FCC's Cable Rate Survey Does Not Appear To Provide a Reliable Source of Information on the Cost Factors Underlying Cable Rate Increases

FCC's annual cable rate survey seeks information on cable franchises' cost changes that may underlie changes in cable rates during the preceding year. To evaluate the reliability of these statistics, we asked 100 of the approximately 700 franchises that the FCC surveyed in 2002 to describe how cost change information that they provided to the FCC was calculated. Figure 1 shows the actual portion of the FCC survey which franchises completed to provide their cost change information.

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[2] The 1984 Act restricted regulation to only basic services for cable systems not subject to effective competition. In its rulemaking, the FCC initially said that effective competition existed if three or more over-the-air broadcast signals existed in a given market. Under this narrow definition, over 90 percent of all cable systems would be subject to effective competition and therefore not subject to rate regulation.

[3] Basic and expanded-basic are the most commonly subscribed to service *tiers*—bundles of networks grouped into a package—offered by cable companies. In addition, customers in some areas can purchase digital tiers and also premium pay channels, such as HBO and Showtime.

[4] See, U.S. General Accounting Office, *Telecommunications: Issues in Providing Cable and Satellite Services*, GAO–03–130 (Washington, DC: Oct. 15, 2002).

[5] In a similar analysis, the FCC found that cable rates in franchise areas with a wireline competitor were nearly 7 percent lower than in franchise areas without such as competitor. See, Federal Communications Commission, *Report on Cable Industry Prices*, FCC 02–107 (Washington, DC: April 4, 2002).

Figure 1: Section of FCC's 2002 Rate Survey Covering Rate and Cost Changes

E. Programming Service Charges in Community

In the following, the "basic cable service tier" or **BST** is the service tier that includes the retransmission of over-the-air broadcast signals and may include a few satellite or regional channels. A "cable programming service tier" or **CPST** is any other tier containing programming other than that on the BST, pay-per-channel, or pay-per-view. **CPST1** refers to the major CPST and typically meets two criteria: It has the most channels and most subscribers among the CPST tiers (if more than one CPST is offered). Sometimes a "mini-tier" with considerably fewer channels has the most subscribers among the CPSTs. This mini-tier is considered **CPST2**, whether or not it has the most subscribers.

	Monthly Charges for Programming Services	July 1, 2000	July 1, 2001	July 1, 2002
48	Monthly charge for **BST**			
49	Monthly charge for **CPST1**			
50	Monthly charge for **BST plus CPST1** (rows 48 + 49)			
51	Year-to-date change in monthly charge on row 50	-----		

For July 1, 2001 and July 1, 2002, allocate the change shown on row 51 by estimating the dollars and cents that each factor, below, contributed. The total of these factors (row 58) should equal the change on row 51.

		July 1, 2000	July 1, 2001	July 1, 2002
52	License or copyright fees, *existing* programs	-----		
53	License or copyright fees, *new* programs	-----		
54	Headend or distribution facility investment	-----		
55	General inflation, not included elsewhere	-----		
56	Other cost changes (positive or negative)	-----		
57	Non-cost-related factors (positive or negative)	-----		
58	Total of rows 52-57 (must equal row 51)	-----		

Source: 2002 FCC Rates Survey

Our discussions with cable franchises indicated considerable variation in how franchises completed this section of the 2002 FCC cable rates survey. Our preliminary observations indicate that there are two causes for the resulting variation: (1) there were insufficient instructions or examples on how the form was supposed to be completed, leading to confusion among cable operators regarding what to include for the different cost factors and how to calculate each of them; and (2) the requirement that the cost and non-cost factors sum to the reported annual rate increase caused many cable operators to adjust one or more of the cost factors, thereby resulting in data that might not provide an accurate assessment of the cost factors underlying cable rate increases.

Lack of adequate instructions. Our interviews with 100 cable franchises indicate that the lack of specific guidance regarding the cost change section of the survey caused considerable confusion about how to fill out the form. Every franchise that we spoke with said it was unclear what the FCC expected for at least one of the 6 factors (5 cost factors as well as a non-cost factor); 73 of the 100 franchises said that the instructions were insufficient. In particular, several cable representatives we interviewed noted that there were no instructions or examples to show how to calculate investment, what types of cost elements should go into the *other costs* category, and what the FCC meant by non-cost factors. This lack of guidance created considerable variation in the approaches taken to develop the cost factors. Table 1 provides information on the approaches cable franchises used to complete the portion of the survey pertaining to cost and non-cost factors underlying rate changes.

Table 1: Summary of Approaches Used by Cable Franchises to Calculate Cost and Non-Cost Factors

Type of cost/non-cost factor (line of the FCC survey)	Discussion of how franchises approached this factor
License or copyright fees, existing and new programs (lines 52 and 53)	Most of the cable companies told us they used specific cost data on existing programming costs to develop the cost changes associated with increases in existing programming. Thirty-nine of the 47 franchises that reported an increase in new programming costs said they used actual information to calculate these cost changes.

Table 1: Summary of Approaches Used by Cable Franchises to Calculate Cost and Non-Cost Factors—Continued

Type of cost/non-cost factor (line of the FCC survey)	Discussion of how franchises approached this factor
	Some companies took a standard company-wide approach to estimating programming costs as opposed to estimating the costs for each individual franchise. Some companies combined cost changes for all programming without separating existing from new programs.
Head-end or distribution facility investment (line 54)	Eighty-three of the 100 franchises we surveyed entered zero for these infrastructure investments. Of these, 33 told us that there had, in fact, been additional costs for such upgrades that year. The reasons provided to us for leaving it blank included concern that it would be too difficult to determine how much of these costs would be appropriately allocated to a certain video service or franchise. Some cable companies performed significant calculations to estimate how much should be allocated to the support of video services, while other estimates did not include detailed cost calculations.
General inflation (line 55)	Fifty-seven of the 100 franchises estimated inflation by using either FCC or Bureau of Labor Statistics' inflation factors. Other companies left the inflation factor blank because they assumed that most inflation would be captured in the other cost factors.
Other cost changes (line 56)	Sixty-four of the 100 franchises filled in a zero for the *other cost* factor. Of these 64 franchises: Thirty-two told us that there were, in fact, cost changes that would have appropriately been captured in the *other* category; Seventeen told us that they did not understand what items should be included in *other costs*; and Fifteen told us that by the time they got to this line on the form, they had already accounted for enough costs to offset the reported rate increase and thus, they did not evaluate whether there were any costs that should be included as *other costs*.
Non-cost-related factors (line 57)	Eighty-seven of the 100 respondents said they did not understand what non-cost factors would cover, and as a result, 76 of the respondents left the *non-cost* factor blank. Those that did enter a number for this factor cited such items as a change in profit margin or the need to establish uniform rates across franchises.

Source: GAO Survey of 100 Cable Franchises

Requirement that factors sum to the reported annual rate change. Our survey of 100 cable franchises that responded to the FCC's 2002 cable rates survey indicated that a second source of confusion relates to the requirement that the sum of the underlying cost and non-cost factors (see fig. 1 lines 52–57) equal the change in the franchise's cable rates (see fig. 1 line 51). This portion of the FCC's survey was originally designed during the 1990s when both basic and expanded-basic services were regulated. At that time, cable companies were required to justify any rate increases the cable company implemented based on cost increases that it had incurred during the year. An FCC official told us that the rate/cost factor portion of the form was designed to mirror a regulatory form that was used at that time to justify rate changes. When expanded-basic services were deregulated in March 31, 1999, the FCC realized that cost factors would no longer necessarily equal the yearly rate change because companies were no longer required to tie rate changes to explicit cost factors for regulatory purposes.[6] In the 1999 cable rates survey, the FCC added the non-cost line in this section of the survey and continued to require that the cost factors and the non-cost factor sum to the reported annual rate change.

FCC officials told us that cable operators could use the non-cost factor element to make up any difference (positive or negative) between their changes in costs and

[6] In unregulated markets, for example, costs are an important factor in price setting by companies, but several other key factors, such as consumer demand and the competitiveness of the market also influence market price.

rates. However, based on our findings, it appears that this may not have been clearly communicated to cable franchises. We found that only 10 franchises took this approach and instead, most franchises told us that they chose to change their estimate of one or more of the cost factors. In most cases, cable representatives told us that this meant *reducing* other cost factors because most franchises told us that their actual annual cost increases for the year covered by the 2002 survey exceeded their rate change for expanded-basic service.[7] In other words, most franchises—84 of the 100 franchises we spoke with—did not provide a complete or accurate accounting of their costs changes for the year. The following are some examples of how the franchises we surveyed chose to equalize the cost factors with the rate change.

- Fifteen franchises said they entered dollar values in the factors until the entire rate increase was justified and did not consider the remaining cost factors;
- Twenty franchises said they chose to adjust the dollar estimates in existing and/or new programming in order to balance costs and rates;
- Seven franchises said they chose to adjust the costs included for investment in order to balance costs and rates;
- Twenty-seven franchises said they chose to adjust the amount of their inflation estimate to ensure that costs and rates were in balance;
- Twenty-six franchises said they chose to adjust the *other costs* factor to ensure that costs and rate changes were in balance; and
- Four franchises said they adjusted more than one of the cost factors in order to balance costs and rates. For example, one franchise chose to adjust all of the factors by a uniform percentage in order to retain a constant ratio of cost increases.

FCC's Process for Updating and Revising its Classification of the Competitive Status of Cable Franchises May Lead to Classifications That are No Longer Accurate

The 1992 Cable Act established three conditions for a finding of effective competition, and a fourth was added in the 1996 Act. Specifically, a finding of effective competition in a franchise area requires that the FCC has found one of the following conditions to exist:

- Fewer than 30 percent of the households in the franchise area subscribe to cable service (low-penetration test).
- At least two companies unaffiliated with each other offer comparable video programming service (through a wire or wireless—e.g., DBS—service) to 50 percent or more of the households in the franchise area and at least 15 percent of the households take service other than from the largest company (competitive provider test).
- The franchising authority offers video programming service to at least 50 percent of the households in the franchise area (municipal test).
- A local telephone company or its affiliate (or any other company using the facilities of such carrier or its affiliate) offers video programming, by means other than direct broadcast satellite, that is comparable to that offered by the cable provider in the franchise area (LEC test).[8]

Franchising authorities have primary authority to regulate basic cable rates. However, these rates may only be regulated if the cable system is not facing effective competition. Under the FCC rules, in the absence of a demonstration to the contrary, cable systems are presumed not to face effective competition. The cable operator bears the burden of demonstrating that it is facing effective competition.[9] Once the presence of effective competition has been established, the franchising authority is no longer authorized to regulate basic cable rates. FCC does not independently update or revise an effective competition finding once it is made. An effective competition finding may be reversed if a franchising authority petitions to be recertified to regulate basic rates by dem-

[7] Many franchises said that their profit margins for basic and expanded cable services decreased in 2002, but many said that those decreases were offset by increased profits from other services, such as cable Internet and digital cable. The 3 franchises that said that their rate increase exceeded their cost increases made the two balance by entering a positive number in non-cost-related factors.

[8] For this test to be applicable, the telephone company and the cable provider must be unaffiliated.

[9] In some cases, franchise authorities do not wish to regulate rates and cable companies may choose not to file for a determination of effective competition, even if conditions warrant.

onstrating that effective competition no longer exists. However, such petitions are rare.

Our preliminary review of the approximately 700 cable franchises that responded to the FCC's 2002 cable rates survey suggests that the agency's lack of any updates or reexamination of the status of competition in franchise areas may lead to some classifications of the competitive status of franchises that do not reflect current conditions. For example:

- Forty-eight of the 86 franchises in the sample that the FCC had classified as satisfying the low-penetration test for effective competition actually reported current information to the FCC on their operations that appeared, based on our preliminary calculations, to indicate that current penetration rates are greater than the 30 percent threshold.[10] Ten cable franchises appeared to have a penetration rate exceeding 70 percent—a full 40 percentage points above the legislated low-penetration threshold.
- Forty of the 262 franchises in the FCC survey that had been classified as having effective competition by the FCC also reported that the franchising authority was currently regulating basic service rates. This would not be in accord with the statutory requirement. It is possible that such an inconsistency could occur because cable companies incorrectly completed the FCC's survey in some fashion.
- Although the survey form asks the cable franchise whether they face effective competition in the franchise area, those responses are not always consistent with information maintained by the FCC regarding whether there has been an official finding of effective competition. When the FCC's information conflicts with the survey response, the FCC overrides the answer provided by the cable franchise. We found that the FCC staff overrode the survey responses on effective competition for 24 percent of all franchises in its 2002 survey.

Also, we have searched for instances in which franchising authorities sought to have a finding of effective competition reversed. We found two instances in which the FCC reversed a finding of effective competition. However, in one of these instances involving ten franchises in Delaware, some of the franchises appear to remain classified as having effective competition even though the FCC reversed the position in 1999.

In its 2002 *Report on Cable Industry Prices*, the FCC acknowledges that the classification of the competitive status of some franchises may not reflect current conditions. Some franchises that face competition may not have filed a petition, and therefore are not classified as facing effective competition. Also, some franchises may have previously met the criteria for a finding of effective competition, but because of changing circumstances may not currently meet the criteria and remain classified as facing effective competition.

Additional GAO Work on Cable Rate and Competition Issues

We are conducting additional work on the issues discussed today and a more complete analysis will be included in our final report, which we plan to issue in October 2003. In addition to the topics discussed today, we will be providing a more comprehensive analysis of the factors underlying recent cable rate increases, the impact of competition on cable rates and service, and cable tiering issues.

Mr. Chairman, this concludes my prepared remarks. We would be pleased to answer any questions you or other Members of the Committee may have.

The CHAIRMAN. Thank you, Mr. Shear.

What you are telling us in your report is that the FCC's methodology that they are presently employing will not give us a totally accurate depiction of the state of the cable rates at this time. Is that basically what you are saying?

Mr. SHEAR. That is basically what we are saying. And what we are focusing on is really conducting economic analysis of what determines cable rates and reasons for the increases. So we are focusing on that——

The CHAIRMAN. Can you provide recommendations to the FCC to make their methodology accurate?

[10] We calculated the penetration rate by dividing the number of franchise subscribers by the number of households in the franchise area, as reported by the cable company to the FCC.

Mr. SHEAR. We are very glad to say that we have a very constructive relationship and will be working with FCC with certain ideas. At this point, we are focusing on things such as providing better guidance examples to the cable companies to fill out the information better. But we are going to have a dialogue with FCC as far as their options for improving the survey and the costs that could be involved to FCC of improving the survey.

The CHAIRMAN. From the information you do have, whether the increase is 6 percent or 17 percent lower, the rates are where competition exists, does not the status suggest that consumers are being gouged on cable rates where there is ineffective competition? Or is it too early to tell?

Mr. SHEAR. I would not want to characterize—I will say this quite heartily, that—as far as what words are ascribed to it. We certainly stand behind our estimate, based on previous work, that we think the differential between competitive and non-competitive markets, the way we define it, which is an economically based definition, we think that 17 percent is a more realistic number, in terms of what wireline competition can bring to a particular marketplace.

The CHAIRMAN. So do the annual rate increases that most Americans face suggest a lack of effective competition to you, in the industry as a whole?

Mr. SHEAR. The differential suggests a lack of competition, that competition does have a major effect on rates. Effective competition is not evident in many markets. As far as the rate increases, we are still, as we go forward, we are going to be addressing reasons for the rate increases in both competitive and noncompetitive markets.

Ms. ABRAMOWITZ. And I would just like——

The CHAIRMAN. From the review you have conducted so far, what factors do you believe are contributing the most to the yearly increases in cable rates?

Mr. SHEAR. I mean, I think programming costs always come up, and it certainly shows up in the survey as a major cost. Our question is what the relative magnitude is. And as we go forward with this work, we are collecting a lot of information through SEC disclosures, analyst reports, from program providers, from cable operators to try to get a better handle on, more specifically, what types of cost increases are underlying the rate increases.

The CHAIRMAN. In your report last year, so far DBS had not posed an effective—in your views, had not posed effective competition to cable. Do you think over time that will happen?

Mr. SHEAR. I will ask Amy to answer that question. She was the assistant director on that assignment.

Ms. ABRAMOWITZ. I think you are right, that we did not find a pricing effect of DBS, but we did find other important effects. In particular, DBS made much more headway, in terms of their market share, where they were rolling out local to local, and that was a very strong finding. And we also found that, where DBS had rolled out local to local, that the quality, in terms of the number of channels of the cable providers, was higher.

Additionally, in our preliminary work so far, we have found some discussions of changes in what cable companies are doing on price;

in particular, how they are structuring their tiering to respond to some of the low-priced DBS offerings. So I think as DBS becomes more penetrated, it is certainly possible that there will become a stronger pricing effect in addition to the quality effect that it has.

The CHAIRMAN. Mr. Shear, given your surveys and looking at this entire issue so far, and I understand it is preliminary——

Mr. SHEAR. Yes.

The CHAIRMAN.—we will receive a final report in October—what do you think of this a la carte idea? We all know that people now have to purchase channels that they will never watch. A lot of senior citizens in Sun City do not watch ESPN, and yet they pay for it. There are a lot of programs that are just obviously thrown in that people are required to purchase whether they want to or not. What do you think, so far, of this whole—do you have any preliminary ideas about this a la carte idea?

Mr. SHEAR. We are exploring the a la carte idea, and we are also exploring the idea of what you could call "mini tiers." And we are doing it in a context that we are mindful of some of the economic and technical limitations that could be involved in going all the way to an a la carte basis. But, in terms of the data that we are collecting and analyzing, we are trying to see how feasible, even from a statutory point of view, but how feasible, from a statutory, from a economic, from a technical point of view, it would be to move in the direction of, if not a la carte, toward more mini tiers.

The CHAIRMAN. Many tiered rather than straight a la carte.

Mr. SHEAR. Right.

The CHAIRMAN. Senator Wyden?

Senator WYDEN. Thank you, Mr. Chairman.

The CHAIRMAN. We have another panel. I would tell my colleagues——

Senator WYDEN. I just have a couple of quick questions.

The CHAIRMAN. I am not asking you to restrain, but I would appreciate if we did not run too much over time, because we have another panel. But we will have a second round, if necessary, with this witness.

Senator WYDEN. Thank you, Mr. Chairman. Just a couple of quick questions, if I might.

When I looked at the FCC's report on cable prices in 2001, I saw two disturbing observations. The Federal Communications Commission found that cable operators owning two or more cable systems had rates averaging 23 percent higher than single-system operations, and it found that cable operators with a large number of subscribers tended to charge more than their smaller counterparts. Has GAO found any evidence which would dispute the proposition that the larger the cable operator, the higher the rates?

Mr. SHEAR. Based on our work to date on this assignment, we have not examined that issue, as far as size of the cable operator, but it is certainly something that we can and will consider as we go forward.

Senator WYDEN. Have you found any evidence that would dispute it? Because it seems to me the Federal Communications Commission already raised the serious prospect that that is the case, and I would like to know if you have found any evidence to the contrary.

Ms. ABRAMOWITZ. I think, actually, that that finding is fairly similar to one that we found in our report 6 months ago that did an econometric model, although the magnitude I do not believe was——

Senator WYDEN. All right, one last question, if I might, because I think the evidence is pretty clear on that, that the larger the operator, the higher the rates. And I would like to have you continue to explore that proposition.

The other question I had is, Have you looked at anything that would relate to where cable rates go after a major merger? Because this, again, based on the evidence that I see, is one of the reasons we are seeing rates spike up.

Either of you.

Ms. ABRAMOWITZ. We have not done——

Mr. SHEAR. Yeah, I will——

Ms. ABRAMOWITZ.—any work on that specifically. But going forward, I mean, I think that would be an appropriate thing to look at. And since there has been a recent merger, it certainly would open the opportunity to do our model again in a year or two.

Senator WYDEN. OK.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you. I do not mean to rush the Members. We will take all the time necessary. I did want to mention we have another panel, but we will take whatever time is necessary.

Senator Stevens?

Senator STEVENS. Thank you. A couple of questions.

I did not hear. What timeframe did you review?

Mr. SHEAR. We reviewed survey responses that came to FCC in 2002, so these are the survey responses that FCC will be using in their cable rate report that should be out shortly.

Senator STEVENS. I asked the question because was not that a pretty poor year for business, in general? And were not revenues down during that year?

Mr. SHEAR. To us, at this stage, we have to take into account, as we go forward, basically what the economic environment is. At this stage, what we are reporting on is basically how accurate, how reliable are the data provided by the survey to provide an analysis of cable rates and reasons for their increase.

Senator STEVENS. And did you review programming costs as well as cable rates?

Mr. SHEAR. In terms of programming costs, the stage we are at now is we have just begun to kind of meet with programmers to gather information about programming costs, and this will be in our work that will be included in our October report.

Senator STEVENS. Ms. Abramowitz, I did not quite understand your comment about the impact of the direct-broadcasting concept. I assume you are talking about Murdoch's entry in the market?

Ms. ABRAMOWITZ. No, I am just talking generally about the impact of the presence of DBS on cable rates. And in the study that we did 6 months ago——

Senator STEVENS. Could you pull that mike down a little bit?

Ms. ABRAMOWITZ. Oh, I am sorry.

Senator STEVENS. Just from the—that is it.

Ms. ABRAMOWITZ. The study that we did 6 months ago, we were asked to look at the competitive dynamic between DBS and cable rates, what impact the presence of DBS in the market, particularly if local to local was offered, had on cable rates. And our model was largely designed to focus on that. And what we found was that while the presence of DBS, and, in particular, the provision of local into local, had a very profound impact on the penetration of DBS, we did not find that cable rates were lower where local to local was present.

Senator STEVENS. Did you examine at all, the uniformity of costs? For instance, did you differentiate between those who pay Universal Service fees and those who do not?

Ms. ABRAMOWITZ. No, the model was not designed to look at that.

Senator STEVENS. Thank you very much.

The CHAIRMAN. Senator Lautenberg?

Senator LAUTENBERG. I wanted to review one thing with Mr. Shear, and that is the 1996—Congress decided to sunset the FCC rate regulation on the upper-tier programming on March 31, 1999. This was based on a belief that cable operators would face competition from satellite and television providers; others, wireless cable telephone companies. Satellites emerged, just pertinent to the discussion you were just having, as the only significant competitor to cable, partly due to the Satellite Home Viewer Act of 1988 and the Improvement Act of 1999.

Do you see a need for congressional action to increase competition between cable and satellite?

Mr. SHEAR. I think your question is very closely related to the Chairman's, as far as what's the effect of satellite on cable rates. So we are going to be—as we go forward, we are going to be further analyzing the issues of what determines cable rates, cable rate increases. And we certainly expect that our October report will provide some input into decisions having to do with oversight of the cable industry.

Senator LAUTENBERG. Yes, do you recommend any other options for keener competition and better control of the rates as a result of that competition?

Mr. SHEAR. We do not have any recommendations at this time. I will say that as far as other work on cable, on the cable industry, that we are doing for another committee, that we are looking at questions of the role of over-builders, in terms of the competitive landscape.

Senator LAUTENBERG. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Burns?

Senator BURNS. I just was interested in the line of questioning by the Chairman, and I think most of my questions were like that. I have just got a couple of questions here.

Did you survey advertising sales on the cable?

Ms. ABRAMOWITZ. We are collecting information on advertising. And, in fact, we also met with an advertising firm to better understand how advertising plays into cable revenues. And we are, in our data collection, asking for company-wide advertising revenues for 5 years, to look at that.

Senator BURNS. And while you are doing that, I would suggest that you look into what channels on a cable system are most requested——

Ms. ABRAMOWITZ. Yes.

Senator BURNS.—and also would derive income from that. I know there is a lot of—I know whenever we buy, or I used to buy, cable, we had a request of where we would like to be placed, on what channel and whatever. Now, some cable systems do not give you an option to do that. They just say, "Well, you have just got to take us. You know, we will place the advertising."

How about, did you survey the capital investment that was made by cable companies to upgrade their systems, to broaden their capacity, and to make way for broadband and Internet services? Also the telephone services that some of them have gone into. How about—into capital investment, especially to facilitate broadband two-way interconnect?

Ms. ABRAMOWITZ. Well, in terms of FCC's data, there is information that the cable companies are asked to submit about any infrastructure investment related to video. And so that information is in their survey. We are giving all of the major cable companies a template of financial information that we are asking them to fill out going back about 5 years, and infrastructure investments is one of the things that we are asking and trying to gather.

Senator BURNS. In my State of Montana, in which we are rural, and we have the highest penetration of satellite television of just about any state in the world—40 percent of my state is hooked to the satellites. Now, mainly that is necessity, because we have got a lot of dirt between lightbulbs, and you are not going to get a cable by every house. But, also, we have—even in the areas where cable does go by the home, we still have a high, high penetration by the satellite people. And so I think most of mine—and we will hear from some witnesses in a little bit, and I have some questions for them that will maybe bring this more to light—but I would suggest that you study the investment, what they have done. Because we know 2000 was not a great revenue year for the entire telecommunications industry. Wall Street began to look at all companies, from a standpoint of investment, was not a very good investment. So I would like to know how these companies made their investment. And I have been told it is huge.

Also, on the point of Senator Wyden, of the larger—the larger the cable system, the higher the rates—there also has to be some comparison of services, too. And some of the smaller companies do not offer all the services.

On the a la carte situation, did you survey any cable company operating anywhere in this country that offered a lower rate for a sort of a Volkswagen approach to cable? In other words, to receive local to local news or programming and maybe PBS and some barebones offerings in any of the cable systems for those folks who did not care whether they watched it, kicked it, hit it, or "throwed" it.

Mr. SHEAR. I think we have observed that, normal distinctions between basic and expanded service, but as far as—I do not think we have located a cable company yet that would break down, I think, in the way that you are suggesting.

Senator BURNS. Thank you very much.

The CHAIRMAN. Senator Smith?

Senator SMITH. Thank you, Mr. Chairman.

I wonder if during your study, did you include the investments that cable made on advanced services, like broadband, in coming up with your report?

Mr. SHEAR. We have not to date. As Amy just pointed out, we are collecting information. We have a template we are providing to the cable companies that will include certain questions about their infrastructure investments.

Senator SMITH. I would be very interested to know whether cable rates have gone up as a result of these broadband investments, because I think that that is an important calculation and certainly something I hope you will answer for us.

Mr. SHEAR. Yes.

Senator SMITH. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Nelson?

Senator NELSON. Mr. Shear, what questions are you asking on your survey on programming?

Mr. SHEAR. I will refer to Amy on that.

Ms. ABRAMOWITZ. We are meeting with about 15 to 20 cable networks, and we have a template of questions that we are asking about the underlying costs that they face in producing their programming. And often they will discuss that pretty extensively and what kinds of increases they are charging to the cable companies. And so we are basically trying to have a discussion so that we can better understand the nature of the industry. And we made sure to pick programmers that have an array of types of situations, so we have some that are news producers, some that are sports producers, and so forth, so we try to get as much a flavor as we can.

Senator NELSON. So from the answers to those questions, you feel like you are going to have your arms around the question of programming cost.

Ms. ABRAMOWITZ. That, and we also purchase data from an industry vendor called Kagan, which is widely used in the industry, and we are actually asking the programmers that we meet with whether the data reflects pretty accurately their true prices. And so we are trying to cross check that.

Senator NELSON. Do you have any of those answers, thus far?

Ms. ABRAMOWITZ. We're just in the midst of analyzing that, and it would be premature at this point.

Senator NELSON. Thank you.

The CHAIRMAN. Senator Allen?

STATEMENT OF HON. GEORGE ALLEN, U.S. SENATOR FROM VIRGINIA

Senator ALLEN. Thank you, Mr. Chairman.

The key things that people are looking at here in this Committee in this important hearing on cable and competition and so forth is the quality and the costs and how it is all attributed. Senator Burns and Senator Smith have addressed this, and this is just some common sense, and maybe we will get some basic facts for you as we carry forward in this deliberation.

Clearly, there is a lot of investment, and maybe you do not have the amount, but there are just tens of billions of dollars. I have a

figure of $70 billion of investment. So, clearly, when you have an investment, you are going to first, as a business, have to pay off the debt. They did not pay cash for that, so that is going to be a cost and will be reflected in the cable rates. To the extent, as Senator Burns and Senator Smith and I share their interests in determining how much of the cost of cable, which is, on average, supposedly $40 a month—if we can all stipulate it is about $40 a month—how much of that is attributed to some investments, whether it is broadband, which many of us are in favor of—some of it is telephony and so forth.

Insofar as actual programming costs, as best I can determine, programming cost is about $11 a month of that $40. Can you confirm, deny or——

Mr. SHEAR. Well, I think the FCC survey indicates a higher number. Again, we are looking into programming costs.

Senator ALLEN. What is the programming cost, preliminarily, if you have that?

Ms. ABRAMOWITZ. I think the number that you gave, in terms of what underlies the $40 or so, is not dissimilar to what we are hearing, but we are still collecting that information.

Senator ALLEN. Well, if the programming costs, whether it is $11 or $12, have you all determined that—let us assume it is $11, whatever that amount is—that also the cable companies are able to use ESPN, as I understand, which is the number-one viewed cable station, and most people got cable because of sports, motion pictures, in wartime they would like to watch the news. CNN was the precursor of many others. Regardless, are the cable operators able to offset some of that cost by local ad revenue? Are you familiar with that?

Ms. ABRAMOWITZ. Oh, yes.

Mr. SHEAR. Yes. Yes, they can.

Senator ALLEN. Well, I think what would be helpful for us is to get all the components straight. When we were trying to determine what is a fair cost, although I am not who necessarily likes to be telling some in the private sector what is a fair cost or a fair rate of return, but the cable companies are granted monopolies, at least in local areas; however, there is competition. Maybe it is a monopoly on cable; however, there is satellite, and there are other options. And I think the more competition we get, the better quality will be and the better process you will find.

Ms. SHEAR. Senator Allen, this is really getting to the heart of what we are trying to do in producing a report for this Committee, which is really trying to get a handle on the various cost factors that underlie cable rates.

Senator ALLEN. Well, I think that over the years, just from my impression, having lived in a place like Montana, I suppose, not quite as rural, but, nevertheless, they would not even deliver the newspaper to our house, so I thought it was great once the—much less get cable or satellites or any of the rest of it.

I actually think that the programming has been increased; it is better. The costs have gone up, but I think it could be helpful for us to know what those actual programming costs are and what the other business ventures are or the cost of, obviously, financing that

debt. And I would look forward to seeing your more complete report.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Dorgan?

STATEMENT OF HON. BYRON L. DORGAN, U.S. SENATOR FROM NORTH DAKOTA

Senator DORGAN. Mr. Chairman, thank you very much.

I understand this hearing is more about cable systems, but I would like to just ask if there is a way to take a bigger bite at this issue. My colleague, Senator Allen, talked about the advantage of competition, and I certainly agree with that. I think choice and price in a competitive environment is what benefits the consumers. And I think the evidence is all around us that in the range of media industries, whether it is television, radio, newspapers, cable, we are seeing galloping concentration. I mean, this is like the development of a monopoly board that—and it is happening very, very rapidly and in a very serious way. And it will constrict and restrict competition, in my judgment.

And the question is, is anyone, the GAO or others, taking a more global look at this issue? And I ask the question, because the FCC is apparently dressed, ready and poised, to begin marching backward once again, in June, loosening the ownership limits, and a majority of the Members of this Committee have written the FCC asking that they come up and show us what they are planning to do and give us an opportunity to reflect on it.

But are you taking a look at a global view of this issue of competition in a broader range of media industries?

Mr. SHEAR. We are focusing——

Senator DORGAN. Or can you?

Mr. SHEAR.—we are focusing on cable rates in the cable industry, so we hope that it provides useful input in dealing with media-ownership issues. But we are not addressing, ourselves, media-ownership issues.

Senator DORGAN. Well, your work is helpful. And, Mr. Chairman, it might be useful, in addition to that work, to have the charge expanded at some point to a larger, more global look at the media industries and the galloping concentration that is occurring, because it does inevitably pinch the juices of competition, and I think everyone in this Committee believes that competition is good, competition is what gives consumers more choices at better prices.

The CHAIRMAN. Thank you, Senator Dorgan. As you know, we have been trying, to some degree, to look at different aspects of this because of the enormity of the problem, but I agree. And it seems to vary from media to media. We had a very interesting hearing on Clear Channel and radio concentration some time ago, as you know. North Dakota played a prominent role in the discussions.

Finally, Mr. Shear and Ms. Abramowitz, Mr. Hindery is one of the witnesses in the next panel who has been involved in literally every aspect of this industry, and in his testimony he says, “We do know that today only a handful of cable companies control access to more than 90 percent of the Nation’s television households, that today more than half the channels available on the dial are owned

by a company affiliated with the cable industry and that everyday independent nonaffiliated programmers, small and big alike, are discriminated against.” That is a pretty strong statement.

Do you have any agreement or disagreement, or is it too early to tell, with that statement? Either Mr. Shear and/or Ms. Abramowitz.

Mr. SHEAR. I would say that, based on our work, it is too early to tell, but it certainly raises a lot of the questions that we are posing as we go forward with this work.

The CHAIRMAN. Ms. Abramowitz?

Ms. ABRAMOWITZ. Yes, I mean, I would agree that the issues that you mentioned that are in his testimony are issues that are coming up in all of the conversations that we are having, and I think that there will be some discussion of that in our final report.

The CHAIRMAN. Thank you. I thank the witnesses, and we look forward to seeing you when you have your final report. It will be some very interesting discussions. I thank you.

Our next panel is Mr. James Robbins, the president and CEO of Cox Communications; Mr. Charles Dolan, chairman of Cablevision Systems Corporation; Mr. Gene Kimmelman, director of the Consumers Union; Mr. James Gleason, president and COO of CableDirect; and Mr. Leo Hindery, chairman and CEO of YES Network. Please come forward.

And as the panel comes forward, I would like to, because they are not here on the panel today, ESPN and ABC are not here, so I would like to read a statement made by Mr. George Bodenheimer, who is the president of ESPN and ABC Sports. And I quote his press release, “Ripping ESPN and other population networks out of basic cable and charging more for them is not pro-consumer. This would produce a firestorm of protests from cable subscribers. With cable at $40 and the net cost of ESPN about $1, there is no basis to take that step.”

This statement will be made part of the record.

[The prepared statement of Mr. Bodenheimer follows:]

PREPARED STATEMENT OF GEORGE BODENHEIMER, PRESIDENT, ESPN AND ABC SPORTS

“Ripping ESPN and other popular networks out of basic cable and charging more for them is not pro consumer. This would produce a firestorm of protest from cable subscribers. With cable at $40 and the net cost of ESPN at about $1, there is no basis to take that step.”

ESPN Reaffirms Value to Cable

ESPN responded emphatically to the cable industry’s misrepresentation of the network’s impact on retail rates, the understatement of ESPN’s value, as well as certain cable operators’ calls for government regulation of the industry in today’s Senate Commerce Committee hearing and in the media.

ESPN and ABC Sports President George Bodenheimer said, “Our affiliates negotiated and freely signed agreements with our current rate provisions, because they recognize and receive tremendous value in exchange. In calling for regulation, they are looking for the government to give them leverage in private contract negotiations.

Operators continually fail to publicly acknowledge the direct and indirect revenue they generate from ESPN’s industry-leading local ad sales. This local ad sales revenue offsets a significant portion of the wholesale cost. As a result, the net wholesale cost for ESPN is about $1.00 a sub per month.

Cable television as packaged today at $40 a month provides the greatest value in today's entertainment marketplace, and ESPN is a major contributor to cable's success."

Reality of Cable Economics

Bodenheimer continued, "The reality of cable economics is that programming costs are not the most significant factor in driving retail rates. Most cable operators have a very healthy business and a positive economic outlook. Cable retail rate increases go well beyond covering the incremental cost of programming each year. Retail rate adjustments are also covering debt service, paying for acquisitions and recouping infrastructure investment.

According to industry reports, the total cost of license fees paid to programmers for expanded basic cable carriage is approximately $11.00 per sub per month while the average cost of expanded basic cable service to the consumer is about $40. By paying only about 25 percent of its retail price for programming, cable operators' cash flow margins for expanded basic service are on average between 30 and 40 percent. By focusing only on the cost side and ignoring revenue directly and indirectly associated with ESPN services, they are trying to use programmers in general and ESPN in particular as the scapegoats to justify their retail price increases and preserve their high margins."

Bodenheimer said, "Operators have invested $70 billion over the past five to six years in new technologies, which are generating high-margin revenue from digital cable, pay packages, video on demand, broadband and high-speed modem sales. The ESPN brand and content is a major driver of these new revenue streams."

Operators' Ownership of Networks and Carriage Treatment

Bodenheimer added, "Also, many of the major cable operators who criticize sports programming costs and ESPN actually have interests in regional sports networks, national networks carrying sports and sports teams. Most regional sports networks owned by the operators are on basic cable and sold at comparable wholesale prices. These competing networks all stand to gain from potential limitations imposed on ESPN."

A La Carte Not Pro Consumer

"Ripping ESPN and other popular networks out of basic cable and charging more for them is not pro consumer," said Bodenheimer. "This would produce a firestorm of protest from cable subscribers. With cable at $40 and the net cost of ESPN at about $1, there is no basis to take that step.

Also, there are very significant technical and economic realities associated with a la carte which would cost consumers. Subscribers who don't have set-top boxes (more than half of the cable universe) would be forced to pay an additional monthly fee to receive ESPN and other popular services. The loss of ad sales revenue would be substantial, and the resulting loss would be borne by cable subscribers. The consumer would ultimately pay more for a tier, and the price of the service for the remaining bundle of expanded basic services would not come down materially, if at all."

ESPN televises some of basic cable's most highly rated programming. ESPN carried 18 of the top 20 most-viewed programs on ad-supported cable last year. Ratings have increased over the past year. In 2002 and 2003 ESPN has made significant programming additions including the NBA, Wimbledon, the French Open, the Women's NCAA Basketball Tournament and more.

Fact Sheet on Affiliate Rates

ESPN's affiliation agreements were signed freely by operators.

- ESPN's cost reflects the enormous value it delivers to operators.

Programming is only one portion of the costs that affiliates reflect in retail rates.

- Operators' public focus on ESPN's wholesale cost alone ignores completely the substantial revenue ESPN and other networks generate through local ad sales and launch and marketing support, which significantly offsets its license fee.
- It is estimated that ESPN networks alone will generate almost three-quarters of a billion dollars in local ad sales revenue in 2003.
- Operators pay about $11/sub/month for basic cable programming of which over $4/sub/month is recouped through local ad sales alone.
- Cable industry has spent $70 billion upgrading its infrastructure over last 5–6 years (NCTA).

- By selling the new products and services made possible by these upgrades, operator revenues from these services are increasing dramatically.
- Content, like ESPN, is driving much of this revenue.
- What's the problem here?
- The monthly wholesale net cost of ESPN is about $1.00/sub/month.

What is all this public posturing by cable operators about?

- Preserving their 30–40 percent cash flow margins
- Paying for acquisitions, debt service and infrastructure improvements through retail price increases and "blaming" programmers
- If their "solution"—tiering/a la carte—worked, they'd use it with their owned regional sports networks; history and economics show they don't

Consumers are being misled

- Multiple System Operators (MSOs), like Cox, have a positive economic outlook and growing new businesses.
- Moving ESPN to a tier would ultimately cost consumers more and they would get less; the price of the remaining bundle of services would not come down.
- A huge disservice to the 86 percent of Americans who consider themselves sports fans.
- Sports is a key driver of cable.
- ESPN delivers hundreds of teams, colleges, 65 men's/women's sports and more.

Cable is a great value.

- As packaged today at approximately $40 a month, cable provides the greatest entertainment value today.
- Operators should focus on the value rather than the wholesale cost of cable.

The CHAIRMAN. Welcome. We will begin with you, Mr. Robbins. Thank you for coming today.

STATEMENT OF JAMES O. ROBBINS, PRESIDENT AND CEO, COX COMMUNICATIONS

Mr. ROBBINS. Mr. Chairman, good morning. I am sorry, I am taking a minute to get settled in here. You have got a lot of witnesses today, and I will try and be very quick.

Distinguished Members of the Commerce Committee, Mr. Chairman, thank you for the opportunity to testify about cable rates today. I would like to address two related issues of great concern. First, rising programming costs and the consumer benefits of tiering of expensive channels; and, second, network broadcasters' abuse of retransmission consent rules and the harm for consumers of vertical media consolidation.

First, programming costs are driving up cable prices. Any business that retails a wholesale product is subject to market forces. Gas prices go up at the pump when the cost of a barrel of oil rises. Likewise, cable prices increase when programming costs escalate. It would be shortsighted to regulate gas prices at the pump without addressing the influences that drive them. Likewise, it is perilous to regulate cable rates without examining inflated programming prices and the contractual distribution obligations imposed by programmers that are driving up cable prices for everyone.

The Federal Government has recognized the right of cable operators to pass through the entire cost of programming to its customers. In 1992, our expanded basic cable programming costs were 12 percent of basic revenue. Today, video programming is our single-largest expense, behind salaries and labor, comprising about 30 percent of our total costs.

Emboldened by operators' lawful ability to pass programming costs through to consumers, some programmers are seeking outrageous fees for their networks. Last year, we paid 12 percent more for programming. Our total programming expenses topped $1 billion. But with two robust satellite competitors adding a combined 40,000 new customers a week, no cable operator can afford to hike prices by double digits annually.

Last year, Cox's average cable price increase was 5.3 percent, less than the 6.4 percent national average. Meanwhile, our video margins are collapsing. Over the last 5 years, Cox's average programming cost per subscriber has grown twice as fast as the average revenue per subscriber.

Since 1996, Cox has invested $12 billion in its network to provide advanced video, Internet, and telephone services. This network was built with private risk capital, not customer subsidies. Today, Internet and telephone services are fueling our growth. Had we lacked the foresight to invest in our platform and operations to deploy new products, we would be a dying business today.

Sports programming prices, in particular, are skyrocketing. ESPN, last week, announced a 20 percent annual rate hike, another 20 percent increase. Our research indicates that less than a quarter of our customers are avid TV sports viewers, but, unfortunately, all of our customers are forced to foot the bill for pricey sports programming, since Cox is contractually obligated by ESPN to sell its network on our expanded basic-service lineup.

Tiering represents an intriguing solution to improve consumer choice and restore an acceptable price-value proposition for the most expensive networks. I propose that networks that charge Cox a wholesale price of more than $1 per subscriber per month be placed on an optional-service tier that consumers choose whether or not to buy. If operators had the flexibility to sell these networks, sports channels or others, on an optional tier, consumers would gain a significant opportunity to manage their cable expenditures. Likewise, programmers would be motivated to keep their prices reasonable to remain on expanded basic cable lineups.

Second, network broadcasters' retransmission consent abuses are harming cable consumers. Congress established the retransmission consent process to protect and benefit local broadcasters local programming presence. Today, as media consolidation proliferates, networks owning broadcast stations and cable channels manipulate negotiations out of the local market to leverage nationwide carriage of new, unproven cable networks in exchange for retransmission consent in a few markets.

As an example, in early 2000, Cox experienced an ugly battle with News Corp, which demanded nationwide digital carriage of two new cable networks in exchange for retransmission consent for its TV stations in four Cox markets, including WTTG, the Washington, D.C., FOX station. Local customers lost by going without FOX on their cable lineups for 6 days during college bowl season and NFL playoffs before FOX provided, again, its signal to Cox. And Cox customers nationwide were forced to pay more for new, unproven cable channels.

Clearly, unreasonable network demands cost consumers dearly in the form of inflated cable bills and diminished capacity for local

cable operations and local broadcasters to tailor their programming lineups to suit local communities. Additionally, forced carriage of unproven cable channels consume scarce network bandwidth that could impede the availability of such national services as high-definition television.

Cox Communications provides significant value, such as favorable channel position and improved reach, to broadcasters. Policymakers have expressed emphatically that lifeline basic cable prices should not increase faster than the rate of inflation. Thus, Cox must oppose excessive retransmission consent demands for carriage of free, over-the-air, television signals.

As I have noted, Mr. Chairman, massive integrated media companies owning broadcast stations and cable networks already wield tremendous leverage in programming and retransmission consent negotiations at consumers' expense. Relaxing the 35 percent television ownership cap will further harm by bolstering the leverage of big media conglomerates.

Additionally, the vertical-ownership threat posed by News Corp's controlling stake in DirecTV could be fraught with peril for consumers if News Corp is allowed to flex its programming and distribution muscle to dramatically inflate its programming prices while giving preferential treatment to its own networks.

Finally, I urge all of you to carefully consider these important issues and to thoroughly examine and address the myriad powerful forces that influence cable prices before concluding how best to keep cable services accessible and affordable for American consumers.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Robbins follows:]

PREPARED STATEMENT OF JAMES O. ROBBINS, PRESIDENT AND CEO, COX COMMUNICATIONS

Mr. Chairman and distinguished Members of the Commerce Committee, thank you for the opportunity to testify about cable rates. On behalf of my customers and your constituents, I know you share my concern about this important subject. Today, I'd like to address three related issues of great concern: first, rising programming costs and the consumer benefits of tiering expensive channels; second, network broadcasters' abuse of Retransmission Consent rules; and third, vertical integration, coupled with horizontal media consolidation, and its harm for consumers.

First, Soaring Programming Costs are Driving Up Cable Prices.

Providing high value, affordable services to customers is hugely important to me. Cox Communications is proud to be fulfilling the promise of the 1996 Telecommunications Act by delivering the convenience and flexibility of a full-service array of video, high-speed Internet and telephone services from one provider via a single network.

Unfortunately, however, cable prices are rising, and soaring programming costs are largely to blame. Any business that retails a wholesale product is subject to market forces. Gas prices go up at the pump when the cost of a barrel of oil rises. Likewise, cable prices increase when programming costs escalate. It would be shortsighted to regulate gas prices at the pump without addressing the influences that drive them. Likewise, it's perilous to regulate cable prices without a thorough examination of the programming side of the business, and the supply chain that drives our rates.

Sports programming prices, in particular, are skyrocketing. Today, some sports networks demand 20 percent annual rate hikes. When A-Rod signs a baseball contract for $25 million a year, the team and league hike their TV broadcast rights fees. Networks bid aggressively to obtain these rights, and seek to recoup their investment through hefty programming fees charged to cable distributors. I believe

that the only people making money in the sports business are sports programmers, like ESPN, and ball players—at the expense of American consumers.

The Federal Government has recognized the right of cable operators to pass through the entire cost of programming to its customers. In 1992, our expanded basic cable programming costs were 12 percent of basic revenue. Today, video programming is our single largest expense, aside from salaries and labor, comprising about 30 percent of total costs.

Emboldened by the operators' lawful ability to pass programming costs through to consumers, some programmers are seeking outrageous fees for carriage of their networks. Last year alone, Cox's programming costs were up 12 percent—exceeding $1 billion.

But with two robust satellite competitors adding a combined 40,000 new customers a week, no cable provider can afford to hike prices by double digits year over year. Last year, Cox's average cable price increase was 5.3 percent, less than the 6.4 percent national average.

Meanwhile, our video margins are collapsing. Over the last 5 years Cox's average programming cost per subscriber has grown twice as much as average revenue per subscriber.

Since 1996, Cox has invested $12 billion in its network to provide advanced video, Internet and telephone services. This network was built with private risk capital—not customer subsidies. Today, Internet and telephone services are fueling our growth. Had we lacked the foresight to invest in our platform and operations to deploy new products, we'd be a dying business today.

Cable providers are contractually obligated to sell most programming in broad service packages, which include a wide variety of programming. Our research shows that less than 20 percent of our customers are avid TV sports viewers. But sports programming is disproportionately driving up cable prices for everyone.

Tiering presents an intriguing solution to restore an acceptable price value proposition for the most expensive networks—perhaps those that charge Cox a wholesale price of more than $1 per subscriber. If operators had the flexibility to sell these networks—sports channels or others—on a separate tier, consumers would gain an opportunity to manage their cable expenditures by choosing whether or not to buy certain programming. Likewise, programmers would be motivated to keep their prices reasonable to remain on expanded basic cable line-ups.

Second, Network Broadcasters' Retransmission Consent Abuses are Harming Cable Consumers.

Congress established the Retransmission Consent process to protect and benefit local broadcasters' *local* programming presence. Today, as media consolidation proliferates, networks owning broadcast stations and cable channels manipulate Retransmission Consent negotiations out of the local market to leverage nationwide carriage of new, unproven cable networks in exchange for Retransmission Consent in a few markets.

In early 2000, Cox experienced a nasty public Retransmission Consent battle with NewsCorp, which demanded nationwide digital carriage of Fox Movie Channel and Fox Sports World, in exchange for Retransmission Consent for its television stations in four Cox markets, including WTTG, the Washington, D.C., Fox station. Not only did our customers lose by going without Fox on their cable lineups for six days during college bowl season and the NFL play-offs before Fox provided its signal to Cox, but Cox customers nationwide were forced to pay more for new, untested cable channels.

Clearly, unreasonable network demands cost consumers dearly in the form of inflated cable bills and diminished capacity for local cable operations and local broadcasters to tailor their programming line-ups to suit local communities. Additionally, forced carriage of unproven cable channels consumes scarce network bandwidth that could impede the availability of such nascent services as high definition television.

Cox Communications provides significant value to broadcasters in the form of favorable channel position, improved reach and more. Policy makers have expressed the strong preference that life-line basic cable prices should not increase faster than the rate of inflation. Thus, it is critical that Cox oppose excessive Retransmission Consent demands for carriage of free over-the-air television signals.

3. Increasing the 35 Percent Television Ownership Cap Will Further Bolster the Leverage of Programmers and Broadcasters at Consumers' Expense.

As I've noted, massive vertically integrated media companies owning broadcast stations and cable networks already wield tremendous leverage in programming and Retransmission Consent negotiations. Allowing big media conglomerates to acquire

even more TV stations nationwide will strengthen already outrageous Retransmission Consent demands, driving up cable prices, reducing consumer choice and limiting bandwidth for future advanced services.

The vertical ownership threat posed by NewsCorp's recent purchase of a controlling stake in DirectTV could also be fraught with peril for consumers, if News Corp is allowed to flex its programming and distribution muscle to dramatically inflate prices for its programming while giving preferential treatment to its own networks. This tactic, combined with its already formidable leverage over cable operators for Retransmission Consent for its broadcast stations reaching 41 percent of the market, could further reduce the localism that the 35 percent television ownership cap is intended to protect.

I urge all of you to carefully consider these important issues and to thoroughly examine and address the myriad powerful forces that influence cable prices before concluding how best to keep cable services diverse, accessible and affordable for American consumers.

The CHAIRMAN. Thank you.

Mr. Dolan? Would you pull the microphone over in front of you? Thank you.

STATEMENT OF CHARLES F. DOLAN, CHAIRMAN, CABLEVISION SYSTEMS CORPORATION

Mr. DOLAN. Good morning, Mr. Chairman and Members of the Committee.

I am Charles Dolan, chairman of Cablevision Systems Corporation. We are a cable and programming company. Our cable company serves a market of 4 million homes in New York, Connecticut, and New Jersey. Our programming company produces sports, news, and entertainment programming for the New York City area. We also originate six regional sports channels for areas outside of New York, and we operate national cable networks such as American Movie Classics and the Independent Film Channel.

I appreciate this opportunity to present our perspective on the issues before the Committee. And as you will note, our perspective is very similar to Cox's.

Capital spending has long been a way of life for the cable industry. Operating a cable system involves continuous investment to extend and upgrade facilities, especially of late. In the last few years, the cable industry has invested close to $70 billion, as Senator Nelson mentioned a bit ago, to bring advanced digital services to its customers. Cablevision, like other companies, has introduced total addressability, HDTV, VOD, highspeed Internet access, and IP telephony.

Particularly important, this new technology gives our customers greater choice, the power to create the menu they want on the television screens in their homes. Cablevision, as a policy, wants its customers to be able to pick and choose among its services, selecting what appeals to them, rejecting what does not, determining for themselves how much they will spend, just as they do every day in the supermarket or the shopping mall.

Unfortunately, our customers' shopping carts face a littered road ahead, debris left over from our industry's long technological and legislative history. Unwanted programming is being forced into the home, particularly sports programming.

The cable bill at the end of the month is increasing, against the customers' wishes. It may be time to address some of the industry rules and practices that have had these unintended consequences.

Three of these, and I call them "must-buys," are in particular need of reconsideration.

Government-mandated must-buy. The customer cannot buy what he wants from cable until after he has bought the package of programming our government tells him he must buy.

Expanded basic. Now, after the cable customer buys what the government tells him he must, he finds the channels that interest him embedded in a large package of programming. Our industry then tells him he must buy all of these channels in this package, even if most of them are of little or no interest to him, before he is allowed to have any one of them.

Retransmission consent. This is government-granted authority exercised by network-owned and operated broadcast stations or network affiliates. Retransmission consent gives these stations the power to deny the national broadcast networks to local cable audiences. To carry the networks, the cable operator often must agree to compel his customers to buy cable programming owned by the broadcast stations whether these customers want it or not.

So those are the three. Government must-buy through mandatory basic, industry must-buy through expanded basic, network must-buy through retransmission consent. These three must-buys are the building blocks of ever-escalating cable prices. Like any tower made of such unwieldy blocks, when built too high, it must inevitably come tumbling down. What customers want today, what they are beginning to insist upon, is the right to select. The cable customer objects to being told that he must pay for programming he does not want in order to be provided the programming he prefers.

Cablevision's recent dispute with the YES Network is a case in point. When the YES Network came into existence, it demanded from Cablevision nearly four times more than we had paid the year before for the same programming. YES insisted that every expanded basic subscriber pay for this programming, whether or not these subscribers had any interest in the Yankees or baseball or sports.

Cablevision believes that it is the right of the Yankees to set any price they wish for their programming. Cablevision believes, also, that it is the right of each subscriber to accept or reject that price.

Accordingly, Cablevision offered to carry the Yankees and let YES set the price, the price that each interested customer would pay. YES blacked out the Yankees on Cablevision for a year and a half before they grudgingly accepted the principle of that offer.

What has happened since? Of 2 million Cablevision subscribers offered the opportunity to accept the Yankees at $1.95 or less per month, fewer than 9 percent have accepted to date. Ninety-one percent so far have said no thanks.

With the YES experience as context, I respectfully urge you to consider a few specific statutory changes. These would remove impediments to greater customer choice and give customers more control over their cable costs.

First, the statutory must-buy in the Cable Act ought to be eliminated. The must-carry provisions of the Cable Act already compel cable operators to carry all local broadcast stations within a market, even those which may be of marginal interest. The must-buy

provisions go a step further. They require customers to purchase that tier of programming as a prerequisite to the purchase of programming they want. Because of must-buy, our customers are required to purchase all of our broadcast basic tier, adding about $13 to their monthly bill, regardless of whether or not they wish to receive this government-mandated tier.

To help the dairy industry, I ask, would the government insist that all customers entering a supermarket to buy a loaf of bread be required to buy a dozen eggs and a quart of milk before they can purchase their bread?

Second, Congress should establish as a goal that no program vendor may demand, as a condition of carriage, that the cable operator require all his customers to buy that vendor's programming. Let the customer decide.

Third, retransmission consent for broadcast signals should be reevaluated. Commercial broadcast networks and their affiliates are using a valuable government resource, free broadcast spectrum, to leverage carriage of an increasing number of their own cable program channels as a condition of access to the national broadcast networks. As a result, cable operators are forced to carry, and consumers forced to purchase, more and more broadcaster-owned cable programming.

These unfair tying practices are being employed in negotiations over digital carriage, as well. They have had the perverse effect of making it increasingly difficult for cable or independent programmers without such leverage to launch new services.

It is not surprising that retransmission consent has led to a dramatic expansion of control of cable programming by national broadcasters from eight channels before the 1992 Cable Act to 54 today. Overall, all broadcasters now control 63 cable networks.

In this vein, the Committee should note that News Corp's announced acquisition of DirecTV will seriously compound this problem. As Senator Lautenberg noted, in New York, for example, where News Corp owns two VHF broadcast stations, a daily newspaper, a broadcast network, a movie studio, a satellite service, and multiple cable networks, woe be to the cable operator who hesitates to accept News Corp's retransmission demands.

In closing, I appreciate the opportunity provided by the Committee to review adjustments to federal policies. Such adjustments will, in my view, facilitate the beneficial transition to more customer choice. They will reduce the pressure to raise cable rates.

I look forward to answering your questions.

[The prepared statement of Mr. Dolan follows:]

PREPARED STATEMENT OF CHARLES F. DOLAN, CHAIRMAN, CABLEVISION SYSTEMS CORPORATION

Good morning, Mr. Chairman, and Members of the Committee.

I am Charles Dolan, Chairman of Cablevision Systems Corporation. We are a cable and programming company. Our cable company serves a market of 4 million homes in New York, Connecticut and New Jersey. Our programming company produces sports, news and entertainment programming for the New York City area. We also originate six regional sports channels for areas outside of New York, and we operate national cable networks such as American Movie Classics and the Independent Film Channel.

I appreciate this opportunity to present our perspective on the issues before the Committee.

Capital spending has long been a way of life for the cable industry. Operating a cable system involves continuous investment to extend and upgrade facilities, especially of late. In the last few years, the cable industry has invested close to $70 billion to bring advanced digital services to its customers. Cablevision, like other companies, has introduced total addressability, HDTV, VOD, high-speed Internet access and IP telephony.

Of course, this investment is intended to make our services more attractive to our customers and more competitive in the marketplace. Particularly, the new technology that our industry is installing gives our customers greater choice, the power to create the menu they want on the television screens in their home.

Cablevision wishes to offer more for less to everyone. Cablevision wants its customers to be able to pick and choose among its services, selecting what appeals to them, rejecting what doesn't, determining for themselves how much they will spend, just as they do everyday in the supermarket or the shopping mall.

Unfortunately, our customers' shopping carts face a littered road ahead. Debris left over from our industry's long technological and legislative history. Unwanted programming is being forced into the home, particularly sports programming. The cable bill at the end of the month is increasing against the customer's wishes.

It may be time to address some of the industry rules and practices that have had these unintended consequences. Three of these are in particular need of reconsideration:

- Government Mandated "Must-Buy"—the customer cannot buy what he wants until after he has bought what the government tells him he must buy;
- Expanded Basic—after the customer buys what the government tells him he must, then before he is permitted any choices of his own he is required to buy the programming that the industry tells him comes first; and
- Retransmission Consent—this is government granted authority exercised by network owned and operated broadcast stations, or network affiliates. Retransmission consent gives these stations the power to deny the national broadcast networks to local cable audiences. To carry the networks, the cable operator often must agree to compel his customers to buy cable programming owned by the broadcast stations whether they want it or not.

Government must buy through mandatory basic! Industry must buy through expanded basic! Network must buy through retransmission consent!

These three are the building blocks of ever-escalating cable prices. Like any tower made of such unwieldy blocks, when built too high, it must inevitably come tumbling down.

What customers want today, what they are beginning to insist upon, is the right to select. The customer objects to being told that he must pay for programming he doesn't want in order to be permitted the programming he prefers.

Cablevision's recent dispute with the YES network is a case in point.

When the YES Network came into existence, it demanded from Cablevision nearly four times more than we had paid the year before for the same programming. YES insisted that every expanded basic subscriber pay for this programming whether or not they had any interest in the Yankees or baseball or sports.

Cablevision believes that it is the right of the Yankees to set any price they wish for their programming. Cablevision believes also that it is the right of each subscriber to accept or reject that price. Accordingly, Cablevision offered to carry the Yankees and let YES set its own price. YES blacked out the Yankees on Cablevision for a year and a half before they grudgingly accepted the principle of that offer. What has happened since? Of 2 million Cablevision subscribers offered the opportunity to accept the Yankees at $1.95 or less per month, fewer than 9 percent have accepted to date, 91 percent so far have said "no thanks."

With the YES experience as context, I respectfully urge you to consider a few specific statutory changes. These would remove impediments to greater customer choice and give customers more control over their cable costs.

First, the statutory "Must-Buy" in the Cable Act must be eliminated. The must-carry provisions of the Cable Act already compel cable operators to carry all local broadcast stations within a market, even those that may be of marginal interest.

The "Must Buy" provisions go a step further. They require consumers to purchase that tier of programming as a prerequisite to the purchase of programming they want. Because of "Must Buy," our customers are required to purchase all of our broadcast basic tier, adding about $13.00 to their monthly bill, regardless of whether or not they wish to receive this government mandated tier.

To help the dairy industry, for example, would the government insist that all customers entering a supermarket to buy a loaf of bread be required to buy a dozen eggs and a quart of milk before they can purchase their bread?

Second, Congress should establish as a goal that no program vendor may demand as a condition of affiliation that the cable operator require all his customers to buy that vendor's programming.

Let the customer decide!

Third, retransmission consent for broadcast signals must be reevaluated. Commercial broadcast networks and their affiliates are using a valuable government resource—free broadcast spectrum—to leverage carriage of an increasing number of their own cable program channels as a condition of access to the national broadcast networks. As a result, cable operators are forced to carry—and consumers forced to purchase—more and more broadcaster-owned cable programming as part of their expanded basic package regardless of consumer interest in that programming. These unfair "tying" practices are being employed in negotiations over digital carriage as well. They have had the perverse effect of making it increasingly difficult for cable or independent programmers without such leverage to launch new services.

It is not surprising that retransmission consent has led to a dramatic expansion of control of cable programming by national broadcasters, from 8 channels before the 1992 Cable Act, to 54 today. Overall, all broadcasters now control 63 cable networks.

In this vein, the Committee should note that News Corporation's announced acquisition of DirecTV will seriously compound this problem. In New York, for example, where News Corp. owns two VHF broadcast stations, a daily newspaper, a broadcast network, a movie studio, a satellite service and four cable networks, woe be to the cable operator who hesitates to accept News Corp.'s retransmission demands.

In closing, I appreciate the opportunity provided by the Committee to review adjustments to federal policies. Such adjustments will, in my view, facilitate the beneficial transition to more customer choice. They will reduce the pressure to raise cable rates.

Thank you.

The CHAIRMAN. Thank you very much.

Mr. Kimmelman?

STATEMENT OF GENE KIMMELMAN, DIRECTOR, CONSUMERS UNION

Mr. KIMMELMAN. Thank you, Mr. Chairman. On behalf of Consumers Union, the print and online publisher of the Consumer Reports Magazine, I appreciate the opportunity to testify this morning.

Many of you were involved in these debates in the 1980s and 1990s. I want you to think back about whether what we have done in moving from government control of media to more market forces, if it has really succeeded at what you thought and the American people thought we were trying to get out of that.

Let us look at the markets today. You have heard from the Chairman that cable rates are up 50 percent. We have done an analysis of this and looked at the programming costs using FCC data and looked at all the infrastructure investments that were made, and they are enormous, annualized that and looked at the revenue from advertising that has come in, and it has grown in lockstep with these programming cost increases, and looked at all the new revenue—cable modem services, mini-tiers, pay services, and what not—and, low and behold, we find that, on an annualized basis, those new revenue streams can cover virtually all of the costs of programming and infrastructure investment without these cable rate increases. And as the GAO pointed out to you this morning, they are not done, but they have found that in the communities where there are two cable companies, two wires competing

head to head, and two satellite companies, compared to the communities where there are two satellite companies and one cable company in the market, prices are, on average, 17 percent lower for the same programming, approximately. Now, that is only a few percent of the American population. If all consumers had that differential, same programming, approximately, the same infrastructure, they would be saving about $5 billion a year in cable expenditures.

Now, we know that what has happened in the last 20 years is cable has consolidated dramatically. The two largest companies, Comcast and AOL Time-Warner, today control more than half the ownership interest in cable systems around the country. The biggest cable companies do charge more, and, Senator Burns, I believe the FCC measures that looking at a per-channel basis, as well as overall cost.

And we all heard about how clustering, moving cable systems adjacent to each other into one company, ownership structure would reduce cost, bring efficiencies. The FCC said it should bring down prices. The FCC has found the opposite. Prices are higher where cable systems are clustered.

Now, the national television networks have done the same thing. They have expanded and consolidated, two large networks now owning stations serving more than 40 percent of all consumers in the country, gone in-house with most of their production studio arrangements after financial interests and syndication rules were eliminated. And today we have four networks and AOL Time-Warner that are programming juggernauts in prime-time viewing. Those five companies control about the same audience share as the three big networks did 40 years ago. Just imagine.

And now News Corp is buying DirecTV, the largest satellite television company in the country. Is this going to change the picture and bring us more competition? I sure wish it would, but I am afraid it is going to be the opposite. As the Chairman pointed out, News Corp owns the FOX television network, with about 35 broadcast stations around the country, cable properties, FOX News, FX, other cable stations, production studios, as has been mentioned. They own interest in more than 20 sports channels around the country, with rights to 67 teams in the NBA, the NHL and Major League Baseball. DirecTV has a major package of Sunday NFL games. They have a college football package and college basketball package.

This is even more powerful programming brought together under one roof with a company that received retransmission rights in 1992 because it needed to get on cable systems to reach its customers. With DirecTV, it no longer needs to get on cable systems to reach its customers. I believe the cable executives have it right; it is time to review retransmission consent as it pertains to News Corp in this transaction.

Now, many Wall Street analysts believe, as we do, that News Corp is not likely, with all of this ownership of programming, to have an incentive to drive down cable and satellite prices for consumers, unfortunately. Instead, they will have the opposite incentive, to jack up prices for their own programming, pass them along to the cable companies, charge themselves, and pass it along to their only satellite competitor. Everybody pays more for News

Corp's programming, News Corp makes more money, the consumer pays more, regardless of how he or she gets television service.

In other words, this is really a bad deal for consumers, and we are going to be asking the Department of Justice to scrutinize it carefully and impose severe restrictions.

I hope this is not quite the kind of marketplace that you thought, in the 1980s and 1990s, that we were trying to move toward in getting consumers more choices and better prices for media services. I hope you agree with us that now is the time to fix some of these problems.

First, we want you to stop the FCC from doing anything that would allow the national television networks to squeeze out more local programming from local stations. Now is not the time for more nationalism; it is time to reinvigorate local content on television.

We want you to stop the FCC from doing anything that would enable the strongest local broadcasters to join up with the strongest newspapers in their community, the two major sources of news and information in local markets, and dominate distribution of news through one corporate entity.

And we want you to prevent all forms of discrimination. You have just heard about some from the cable industry. I find it amusing that they worry about how they are squeezed. They are the ones who pull the trigger on the prices for consumers. They are the ones who tell the consumer what the package is, in most cases, and what they have to pay. They are right, programmers should not have too much leverage; but they are wrong, they should not have too much leverage.

We want you to review all forms of discrimination in putting together programming packages on the wholesale and retail level and finally, importantly, let the consumer choose what channel he or she wants to watch and buy at a fair price, and make sure the market delivers that.

Thank you.

[The prepared statement of Mr. Kimmelman follows:]

PREPARED STATEMENT OF GENE KIMMELMAN, DIRECTOR, CONSUMERS UNION

Summary

It began in 1984 with the Cable Communications and Policy Act, and a simple and appealing proposition: lift the shackles of regulation on the cable industry and competition will flourish, resulting in lower prices and more choices for consumers. It progressed to broadcast programming with the elimination of public interest programming obligations, and the decision to eliminate the limit on network ownership of prime time programming and culminated in the 1996 Telecommunications Act with the lifting of limits on broadcast station ownership. Consumers were told not to fear deregulation; competition and the antitrust laws would prevent excessive concentration.

Today, almost 20 years later, the evidence of failed promises is everywhere.

- The expected benefits of cable deregulation have not been realized. Robust competition did not materialize, the industry consolidated into a few dominant firms, and rates charged to consumers skyrocketed (see Table 1, p.46). Except during a four-year period in the early 1990s when Congress re-regulated cable prices, rates have risen and continue to rise almost three-times faster than inflation. Since passage of the 1996 Telecommunications Act, cable rates have risen over 50 percent. [1]
- The broadcast networks, which once were limited to ownership of a quarter of prime time production, now own almost three quarters. Independent production

has all but disappeared from the high volume viewing of prime time, both over-the-air and through the cable wire.

- Two of the largest national broadcasters have exceeded the cap set by Congress on the permissible number of stations they may own. Concentration in radio markets has advanced at a shocking pace.

Yet these facts have not weakened many policymakers' enthusiasm for allowing more deregulation and more mergers across all media industries and markets.

The recently announced proposed merger between the News Corporation ("News Corp./Fox") and Hughes Electronics Corporation's satellite television unit "DirecTV," combined with the Federal Communications Commission's (FCC) current efforts to relax or eliminate media ownership rules that restrict ownership of multiple television stations, newspapers and radio stations both locally and nationally, threaten to harm meaningful competition between media companies. Most importantly, this lack of competition will mean that control of media that Americans rely upon most for news, information and entertainment could eventually be placed in the hands of a few powerful media giants.

Consider the powerful interaction of the FCC's rush to lift media ownership rules and the proposed merger between a major network and the largest direct broadcast satellite (DBS) network. In the next month, the FCC is likely to relax ownership rules in a manner that would open the door to further concentration of ownership in a few hands, consolidation of outlets in national chains and conglomeration of control over different types of media. The FCC is considering:

- Relaxing the ban on news/broadcast cross-ownership would allow broadcasters to buy newspapers in the same communities they own local stations (even when there is only one dominant newspaper in that community). News Corp./Fox already has cross ownership ventures.
- Raising or eliminating the cap on how many television stations national TV networks may own (which was set at a level of stations servicing 35 percent of the population by Congress in 1996) would extend national network control over local stations. News Corp./Fox already far exceeds the cap.
- Letting a single TV broadcaster own more than 2 stations in a single market. News Corp./Fox already owns 2 broadcast stations in New York, Los Angeles, Dallas, Washington, D.C., Houston, Minneapolis, Phoenix, and Orlando.
- Although less likely, permitting national TV networks to buy each other (e.g., Fox purchase NBC or Viacom/CBS purchase Disney/ABC).

Unfortunately, the antitrust laws are not enough to prevent the excessive consolidation in the marketplace of ideas that would result from any combination of transactions under these relaxed rules. Antitrust has never been used effectively to promote competition in and across media where there is no clear way—like advertising prices—of measuring competition/diversity in news sources, information and points of view presented through the media.

Consumers Union [2] and the Consumer Federation of America [3] believe Congress should review and alter the laws that enabled industry consolidation spurred by excessive deregulation to weaken or undermine competitive conditions in media markets. The News Corp./DirecTV merger is likely to lead to higher prices for both satellite TV and cable TV, since the combined company can maximize its earnings by inflating the prices it charges for its broad array of popular programming that all cable and satellite customers purchase. And this transaction, in conjunction with relaxed media ownership rules, will spur a wave of mergers among the remaining national broadcast networks, satellite and cable giants.

We believe it is time for Congress to intervene and finally deliver more choices and lower prices for the media services consumers want, and to prevent excessive relaxation of media ownership which threatens the critical watchdog function media companies play in our Nation's democracy. It is time for Congress to drop the rhetoric and look at the reality of deregulated video markets. Congress should:

- Reconsider its grant of retransmission rights to broadcasters, where a broadcaster also owns a second means of video distribution.
- Let consumers pick the TV channels they want for a fair price.
- Prevent all forms of discrimination by those who control digital TV distribution systems and those who control the most popular programming in a manner which prevents competition in the video marketplace.
- Strengthen, rather than weaken, media ownership rules, to prevent companies from owning the most popular sources of news and information in both the local and the national markets.

The News Corporation/DirecTV Merger

If competition in the multichannel video market had performed up to its hope and hype, the News Corp./Fox/DirecTV merger might not be so threatening. But in light of the failure of deregulation, it presents a problem for public policy that cannot be ignored. There are two points of power in the marketplace—distribution and program production. The problem with News Corp./Fox is that it combines the two.

The reach of News Corp./Fox's media empire is truly staggering. The following are highlights of some News Corp./Fox properties in the U.S.:

- Broadcast Television Stations (35 stations, including two broadcast stations in New York, Los Angeles, Dallas, Washington D.C., Houston, Minneapolis, Phoenix and Orlando)
- Filmed Entertainment (20th Century Fox Film Corp., Fox 2000 Pictures, Fox Searchlight Pictures, Fox Music, 20th Century Fox Home Entertainment, Fox Interactive, 20th Century Fox Television, Fox Television Studios, 20th Television, Regency Television and Blue Sky Studios)
- Cable Network Programming (Fox News Channel—the most watched cable news channel, Fox Kids Channel, FX, Fox Movie Channel, Fox Sports Networks, Fox Regional Sports Networks, Fox Sports World, Speed Channel, Golf Channel, Fox Pan American Sports, National Geographic Channel, and the Heath Network)
- Publishing (New York Post, the Weekly Standard, HarperCollins Publishers, Regan Books, Amistad Press, William Morrow & Co., Avon Books, and Gemstar—TV Guide International)
- Sports Teams and Stadiums (Los Angeles Dodgers, and partial ownership in the New York Knicks, New York Rangers, LA Kings, LA Lakers, Dodger Stadium, Staples Center, and Madison Square Garden)

News Corp./Fox's merger with DirecTV adds a new, nationwide television distribution system to News Corp./Fox's programming/production arsenal. DirecTV is the Nation's largest satellite television distribution system, with more than 11 million customers and the ability to serve all communities in the United States.

News Corp./Fox's vast holdings provide it with leverage in several ways. "The biggest, most powerful weapon News Corp./Fox has is 'a four-way leverage against cable operators, competing with satellite and using the requirement that cable get retransmission consent to carry Fox-owned TV stations, while potentially leveraging price for Fox-owned regional sports networks and its national cable and broadcast networks . . .'"[4]

One of News Corp./Fox's most important weapons is significant control over regional and national sports programming. Mr. Murdoch often describes sports programming as his "battering ram"[5] to attack pay television markets around the world. As David D. Kirkpatrick noted in an April 14, 2003 *New York Times* article regarding Mr. Murdoch's control over sports programming:

> In the United States, News Corp./Fox's entertainment subsidiary now also controls the national broadcast rights to Major League Baseball, half the Nascar racing season and every third Super Bowl. On cable, Fox controls the regional rights to 67 of 80 teams in the basketball, hockey and baseball leagues as well as several major packages of college basketball and football games, which it broadcasts on more than 20 Fox regional sports cable networks around the country. By acquiring DirecTV, Mr. Murdoch gains the exclusive right to broadcast the entire slate of Sunday NFL games as well.
>
> With DirecTV, Mr. Murdoch can start a new channel with immediate access to its subscribers, currently 11 million. He has other leverage in Fox News, now the most popular cable news channel, and essential local stations in most major markets around the country.[6]

It is important to consider the ramifications of Mr. Murdoch's control of over 40 percent of Fox broadcast stations nationwide, control of 11.2 million satellite subscribers, and his stranglehold over regional sports programming. With those extensive holdings, News Corp./Fox is in a position to determine what new programming comes to market, and to undercut competitive programming. The company will be able to decide what programming it does not want to carry and may be able to indirectly pressure cable operators (by offering a lower price for Fox programming as an inducement) not to carry programming that competes with Fox offerings. We believe Mr. Murdoch has a right as an owner to put whatever he wants on his system, but with the FCC moving to relax media ownership rules, companies like News

Corp./Fox will have the ability to control key sources of news and information in an unprecedented manner.

The merger between News Corp./Fox and DirecTV is extremely unlikely to stop skyrocketing cable rates and could very well exacerbate the problem. According to David Kirkpatrick's *New York Times* article: [7]

> Some analysts said the structure of the deal suggested Mr. Murdoch hoped to use DirecTV mainly to punish other pay television companies and benefit his programming businesses. The *Fox Entertainment Group*, an 80 percent-owned subsidiary of News Corporation, will own a 34 percent stake in DirecTV's parent, creating the potential for programming deals that favor Fox over DirecTV.
>
> "My sense is that the major purpose for News Corporation controlling DirecTV is to use it as a tactical weapon against the cable companies to get them to pay up for its proprietary programming," said Robert Kaimowitz, chief executive of the investment fund Bull Path Capital Management.

While News Corp./Fox has agreed to abide by the FCC's program access requirements, [8] this pledge could end up being nothing more than a tool for pumping up cable prices. That is, while News Corp./Fox agrees to make its programming available on non-discriminatory terms and conditions, there is absolutely nothing that would prevent News Corp./Fox from raising the price that it charges itself on its satellite system, in return for increased revenues from the other 70 million cable households. If a cable system refuses to pay the increased price, then News Corp./Fox will be able to threaten cable operators to use its newly acquired satellite system to capture market share away from cable in those communities.

An article in the *Washington Post* [9] recently detailed the way this might work:

> For instance, News Corp./Fox raised the cost of his Fox Sports content to some cable systems by more than 30 percent this year, according to one cable operator. Like most officials interviewed yesterday, he refused to be identified, saying he had to continue dealing with News Corp./Fox.
>
> Most recently, in Florida, News Corp./Fox pulled its Fox Sports regional sports programming off of competitor Time Warner Cable's system over a rate dispute. News Corp./Fox wanted to charge more than Time Warner was willing to pay, but the conflict was resolved and service restored. "If this happens when Rupert owns DirecTV, you can assume DirecTV will go into the market and just pound away at the cable system," said one cable channel executive.

And price is only the beginning of the problems in this industry. Even in the 500-channel cable universe, control of prime time programming rests in the hands of a very few media companies. Given the enormous power that will be concentrated in News Corp./Fox as a result of the DirecTV transaction, not only will the combined entity be able to insist on top dollar for its programming, it will be able to determine who makes it and who fails in the programming marketplace.

Cable Rates Have Escalated

In 1984, proponents of cable deregulation argued that competition from broadcasters and hoped-for sources like satellite television would keep prices down for consumers. The actual result? Massive consolidation and skyrocketing rates. In response, Senators Danforth, Gorton, Inouye and others led the charge in the early 1990s to clamp down on some of the most egregious excesses resulting from cable deregulation. However, in the 1996 Telecommunications Act, Congress went in the opposite direction, deregulating cable when the industry promised that it would become an aggressive competitor to local phone companies, and new competitors were entering the cable market.

But the cable industry has failed to deliver on its promises to Congress, regulators and the American people. Despite the growth of satellite TV, the promise of meaningful competition to cable TV monopolies remains unfulfilled. Cable rates are up 50 percent since Congress passed the 1996 Telecommunications Act, nearly three times as fast as inflation. [10]

In response to constant consumer complaints regarding the ever-escalating cost of cable service, cable providers explain that their hands are tied due to price increases from programmers and capital investments required to make new services available. The simple truth is that cable operators have been showing burgeoning profits to Wall Street, which runs at odds with what they have told their customers and policymakers.

If programming costs were really the sole cause of rising prices, then the cable industry's operating margins—the difference when costs are subtracted from revenues—would not be rising. But the facts are just the opposite. The operating margin

for the industry as a whole was projected to reach $18.8 billion per year in 2002, $7 billion more than it was in 1997.[11]

Operating revenues per subscriber have also increased dramatically over that period, from $208 per year to $273. That is, after taking out all the operating costs, including programming costs, cable operators have increased their take per subscriber by over 30 percent.

The increase in operating revenue is just under $5.50 per month. Basic rate increases over this period were about $8.50 per month. In other words, almost two thirds of the basic rate increases have been taken below the (operating cost) line. To put this another way, each $1 per month price increase raises industry revenues by about $800 million per year. Basic rate increases are driving the increased operating cash flow of the industry.

The fact that cable operators carry the basic rate increases directly to the bottom line underscores a second important point about the industry. The digital upgrade essentially pays for itself though the sale of digital tiers and high speed Internet to tens of millions of cable subscribers.

The ability of cable operators to raise rates and increase revenues, even with rising programming costs, stems from the market power they have at the point of sale. They would not be able to raise prices and pass program price increases through but for that monopoly power.

Competition to Cable not Robust

Head-to-head competition between cable companies is virtually nonexistent. Out of 3000 plus cable systems, head-to-head competition exists in fewer than 200, although another 150 have certified entry. In short, only about 10 percent of franchise territories have experienced head-to-head competition between cable companies. While a number of other communities have authorized additional overbuilding, this activity is slowing, as the regional bell operating companies pull back and pure overbuilders retrench.[12]

Cable's dominance as the multichannel medium is overwhelming, with a subscribership of approximately two-thirds of all TV households. Its penetration is about 3½ times as high as the next multichannel technology, satellite. Because a large number of satellite subscribers live in areas that are not served by cable, competition in geographic markets is less vigorous than the national totals suggest.

This monopoly at the point of sale is reinforced by a strong trend toward regionalization in which one company gains ownership of many firms in a region. Clustering has increased sharply since 1994, up by almost 75 percent.[13] Just over one-half of all subscribers were clustered in 1997 but by 2000 four-fifths were.[14] The FCC has found that clustering is associated with higher prices.[15]

The failure of competition in multichannel video is most evident in local markets. Only one cable company serves over 95 percent of the homes passed in the country.[16] Satellite has about 10 million subscribers in markets where cable and satellite meet. In these markets, there are only 8 million satellite only subscribers. This suggests that cable retains a market share at the point of sale of well over 85 percent.[17] The antitrust concentration index (the Hirschmann-Herfindahl index or HHI) at the local level is above 7000. These market shares and levels of concentration make cable operators virtual monopolies.[18]

The wave of concentration in the industry after deregulation is striking at the national level. When cable was deregulated in 1984, the distribution segment was not concentrated at all (HHI about 350), with the equivalent of about 30 equal sized competitors. A decade later, concentration had advanced to the point where the distribution segment had the equivalent of about 11 equal-sized competitors (HHI about 930). This is just close to the moderately concentrated threshold. Although the FCC claims that the Multichannel Video Program Distribution (MVPD) market falls just below the level of being moderately concentrated (HHI=954), it arrives at this conclusion by ignoring Comcast's substantial direct ownership interests in Time Warner Systems and Cablevision, as well as its stake in Time Warner Entertainment (TWE). Taking Comcast's ownership interests into account places the cable TV market into the moderately concentrated category.

Satellite competition has failed to prevent price increases on cable because cable and satellite occupy somewhat different product spaces. First and foremost, the lack of local channels on satellite systems in many communities prevents satellite from being a substitute for cable; in fact, many satellite subscribers also purchase cable service for the express purpose of receiving local channels. And while many larger communities now receive local broadcast channels from satellite, service is not as attractive as cable in several respects and many consumers simply cannot subscribe. Many urban consumers cannot receive satellite services because of line of sight

problems, or because they live in a multi-tenant dwelling unit where only one side of the building faces south.

Restrictions on multiple TV set hookups also make satellite more costly. The most recent data on the average price for monthly satellite service indicates that consumers pay between $44 and $80 a month to receive programming comparable to basic cable programming. This monthly fee often includes two separate charges above the monthly fee for basic satellite programming—one fee to hook a receiver up to more than one television in the household, and another fee so consumers are able to receive their local broadcast channels.

Satellite customers often subscribe to receive high-end services not provided (until the recent advent of digital cable) on cable systems, such as high-end sports packages, out of region programming, and foreign language channels. In essence, it is an expensive—but valuable—product for consumers that want to receive hundreds of channels.

If satellite were a close substitute for cable, one would expect that it would have a large effect on cable. In fact, the FCC's own findings and data have contradicted the cable industry claims for years. The FCC found that satellite only "exerts a small (shown by the small magnitude of DBS coefficient) but statistically significant influence on the demand for cable service."[19] In the same econometric estimation, the FCC concluded that "the demand for cable service is somewhat price elastic (i.e., has a price elasticity of minus 1.45) and suggests that there are substitutes for cable."[20] This elasticity is not very large and the FCC recognizes that in using the adjective "somewhat." The FCC also attempted to estimate a price effect between satellite and cable. If cable and satellite were close substitutes providing stiff competition, one would also expect to see a price effect. Most discussions in economics texts state that substitutes exhibit a positive cross elasticity.[21] The FCC can find none. In fact, it found quite the opposite. The higher the penetration of satellite, the higher the price of cable.[22]

The most recent annual report on cable prices shows that the presence of DBS has no statistically significant or substantial effect on cable prices, penetration or quality.[23] This is true when measured as the level of penetration of satellite across all cable systems, or when isolating only areas where satellite has achieved a relatively high penetration.[24] At the same time, ownership of multiple systems by a single entity, large size and clustering of cable systems results in higher prices.[25] Vertical integration with programming results in fewer channels being offered (which restricts competition for affiliated programs).[26]

In other words, one could not imagine a more negative finding for intermodal competition or industry competition from the FCC's own data. All of the concerns expressed about concentrated, vertically integrated distribution networks are observed and the presence of intermodal competition has little or no power to correct these problems. The claims that the cable industry makes about the benefits of clustering and large size—measured as price effects—are contradicted by the data. In fact, only intramodal, head-to-head competition appears to have the expected effects. The presence of wireline cable competitors lowers price and increases the quality of service.

While we hope that satellite will ultimately have a price disciplining effect in those communities where satellite offers local broadcast stations it is clear that the single most important variable in cable prices is whether there is a cable overbuilder in a particular community. Wire-to-wire competition does hold down cable rates and satellite does not seem to do the trick. The U.S. General Accounting office describes this phenomenon:

> Our model results do not indicate that the provision of local broadcast channels by DBS companies is associated with lower cable prices. In contrast, the presence of a second cable franchise (known as an overbuilder) does appear to constrain cable prices. In franchise areas with a second cable provider, cable prices are approximately 17 percent lower than in comparable areas without a second cable provider.[27]

In other words, where there are two satellite and one cable company in a market, prices are 17 percent higher than where there are two cable companies and two satellite providers in a market. If we had this type of competition nationwide, consumers could save more than $5 billion a year on their cable bills.

Program Production

The failure of competition in the cable and satellite distribution market is matched by the failure of competition in the TV production market. In the 1980s, as channel capacity grew, there was enormous expansion and development of new content from numerous studios. Policymakers attributed the lack of concentration

in the production industry to market forces and pushed for the elimination of the Financial Interest in Syndication rules (Fin-Syn) that limited network ownership and syndication rights over programming. The policymakers were wrong.

Following the elimination of the Fin-Syn rules in the early 1990s, the major networks have consolidated their hold over popular programming. The market no longer looks as promisingly competitive or diverse as it once did. Tom Wolzien, Senior Media Analyst for Bernstein Research, paints the picture vividly—he details the return of the "old programming oligopoly":

> Last season ABC, CBS and NBC split about 23 percent [of television ratings] . . . But if the viewing of all properties owned by the parent companies—Disney, NBC, and Viacom—is totaled, those companies now directly control television sets in over a third of the TV households. Add AOL, Fox and networks likely to see consolidation over the next few years (Discovery, A&E, EW Scripps, etc.), and five companies or fewer would control roughly the same percentage of TV households in prime time as the three net[work]s did 40 years ago. The programming oligopoly appears to be in a process of rebirth.[28]

In addition, the number of independent studios in existence has dwindled dramatically since the mid-1980s. In 1985, there were 25 independent television production studios; there was little drop-off in that number between 1985 and 1992. In 2002, however, only 5 independent television studios remained. In addition, in the ten-year period between 1992 and 2002, the number of prime time television hours per week produced by network studios increased over 200 percent, whereas the number of prime time television hours per week produced by independent studios decreased 63 percent.[29]

Diversity of production sources has "eroded to the point of near extinction. In 1992, only 15 percent of new series were produced for a network by a company it controlled. Last year, the percentage of shows produced by controlled companies more than quintupled to 77 percent. In 1992, 16 new series were produced independently of conglomerate control, last year there was one."[30]

The ease with which broadcasters blew away the independent programmers should sound a strong cautionary alarm for Congress. The alarm can only become louder when we look at the development of programming in the cable market. One simple message comes through: those with rights to distribution systems win.

Of the 26 top cable channels in subscribers' and prime time ratings, all but one of them (the Weather Channel) has ownership interest of either a cable MSO or a broadcast network. In other words, it appears that you must either own a wire or have transmission rights to be in the top tier of cable networks. Four entities—AOL, Liberty/Fox, ABC/Disney and CBS/Viacom—account for 20 of these channels.

Of the 39 new cable networks created since 1992, only 6 do not involve ownership by a cable operator or a national TV broadcaster. Sixteen of these networks have ownership by the top four programmers. Eight involve other MSOs and 10 involve other TV broadcasters. Similarly, a recent cable analysis identified eleven networks that have achieved substantial success since the passage of the 1992 Act. Every one of these is affiliated with an entity that has guaranteed carriage on cable systems.[31]

Moreover, each of the dominant programmers has guaranteed access to carriage on cable systems—either by ownership of the wires (cable operators) or by carriage rights conferred by Congress (broadcasters).

- AOL Time Warner has ownership in cable systems reaching over 12 million subscribers and cable networks with over 550 million subscribers.
- Liberty Media owns some cable systems and has rights on Comcast systems and owns cable networks with approximately 880 million subscribers. Liberty owns almost 20 percent of News Corp./Fox.
- Disney/ABC has must carry-retransmission rights and ownership in cable networks reaching almost 700 million subscribers.
- Viacom/CBS has must carry-retransmission rights and ownership in cable networks reaching approximately 625 million subscribers.
- Fox (has must carry-retransmission and ownership in cable networks reaching approximately 370 million subscribers and a substantial cross ownership interest with Liberty).

These five entities have ownership rights in 21 of the top 25 cable networks based on subscribers and prime time ratings. They account for over 60 percent of subscribers to cable networks, rendering this market a tight oligopoly. Other entities with ownership or carriage rights account for four of the five remaining most popular cable networks. The only network in the top 25 without such a connection is the Weather Channel. It certainly provides a great public service, but is hardly a

hotbed for development of original programming or civic discourse. Entities with guaranteed access to distribution over cable account for 80 percent of the top networks and about 80 percent of all subscribers' viewing choices on cable systems.

When we examine the ownership of broadcast and cable networks, we discover that almost three-quarters of them are owned by six corporate entities.[32] The four major TV networks, NBC, CBS, ABC, Fox, and the two dominant cable providers, AOL Time Warner (which also owns a broadcast network) and Liberty (with an ownership and carriage relationship with Comcast and Fox), completely dominate the tuner. Moreover, these entities are thoroughly interconnected through joint ventures.

If distribution rights win then an entity like News Corp./Fox/DirecTV would create a powerhouse with guaranteed transmission rights on all three of the technologies used to distribute TV to the home. It will own broadcast stations, have must carry/retransmission rights on cable and satellite because of the broadcast licenses it holds, and own the largest satellite network. This is an immense power of distribution for a company that is vertically integrated into both broadcast and cable programming.

In the 1992 Cable Act, Congress recognized that the Federal Government "has a substantial interest in having cable systems carry the signals of local commercial television stations because the carriage of such signals is necessary to serve the goals . . . of providing a fair, efficient, and equitable distribution of broadcast services."[33] Congress also recognized that "[t]here is a substantial government interest in promoting the continued availability of such free television programming, especially for viewers who are unable to afford other means of receiving programming."[34]

These governmental interests, as well as a finding that "[c]able television systems often are the single most efficient distribution system for television programming," formed the original rationale behind Retransmission Consent. Because a majority of the country was receiving broadcast television service through cable, it was necessary to require that cable systems carry local broadcast signals. However, a merger between News Corp./Fox and DirecTV would change the landscape against which Retransmission Consent was created. Given that this transaction will provide News Corp./Fox with assets that no local broadcaster had in 1992 when Retransmission Consent was originally put in place—it will have a satellite distribution system capable of reaching a majority of the country—it seems that the original logic behind the rule is strained in the present circumstances. Not only will News Corp./Fox own its own transmission system, but it also owns other programming that it bundles with its network programming, which may give it too much market power in negotiating cable and other carriage agreements. Congress should revisit the necessity of Retransmission Consent as it pertains to stations owned and operated by News Corp./Fox.

Conclusion

Consumers Union and Consumer Federation of America believe that Congress should step in and help consumers get a better deal from cable and other media companies.

Congress should impose a new set of nondiscrimination requirements that would enable all media distributors and consumers to purchase video programming and related services on an individual—as opposed to bundled—basis under terms that maximize competition and choice in the marketplace. Congress must reexamine the enormous market power and leverage that Retransmission Consent provides broadcast programmers—particularly one like News Corp. which, as a result of the merger with DirecTV, will own a new nationwide video distribution system (in addition to its over-the-air broadcast distribution system). And Congress should require cable and satellite operators to offer consumers the right to select the channels they want to receive at a fair price—in other words, require an a la carte program offering from all video distributors. Since the average household watches only about a dozen channels of video programming, this requirement could empower consumers to help discipline excesses in cable (or satellite) pricing, and could possibly spur more competition.

Congress must also carefully consider all the ramifications associated with the rulemakings on media ownership. If media ownership limits are significantly relaxed or eliminated by the FCC then the News Corp./DirecTV deal may look almost harmless in comparison to an avalanche of media mergers that ensue. It is completely unfair to force American consumers to accept inflated cable rates and inadequate TV competition. But excess consolidation in the news media is even worse: the mass media provides Americans the information and news they need to participate fully in our democratic society. Without ownership rules that effectively limit

consolidation in media markets, one company or individual in a town could control the most popular newspaper, TV and radio stations, and possibly even a cable system, giving it dominant influence and power over the content and slant of news. This could reduce the diversity of cultural and political discussion in that community.

The cost of deregulating media is very high. The cost of market failure in media markets is the price we pay when stories are *not* told, when sleazy business deals and bad accounting practices do *not* surface, when the watchdog decides that it would rather gnaw on the bone of softer news than chase down the more complicated realities that must be uncovered to make democracy function.

ENDNOTES

[1] Bureau of Labor Statistics, Consumer Price Index (March 2003). From 1996 until March 2003, CPI increased 19.3 percent while cable prices rose 50.3 percent, 2.6 times faster than inflation.

[2] Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education and counsel about goods, services, health and personal finance, and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of *Consumer Reports*, its other publications and from noncommercial contributions, grants and fees. In addition to reports on Consumers Union's own product testing, *Consumer Reports* with more than 4 million paid circulation, regularly, carries articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

[3] The Consumer Federation of America is the Nation's largest consumer advocacy group, composed of over 280 state and local affiliates representing consumer, senior, citizen, low-income, labor, farm, public power an cooperative organizations, with more than 50 million individual members.

[4] Diane Mermigas, *"News Corp.'s DirecTV Monolith."* Mermigas on Media Newsletter, (Apr. 16, 2003), quoting Tom Wolzien, a Sanford Bernstein Media Analyst.

[5] David D. Kirkpatrick, *"Murdoch's First Step: Make Sports Fans Pay."* The New York Times, Apr. 14, 2003.

[6] Id., Emphasis added.

[7] David Kirkpatrick, *"By Acquiring DirecTV, Murdoch Gets Upper Hand."* The New York Times, Apr. 10, 2003.

[8] "As part of the acquisition, News Corp. and DirecTV has agreed to abide by FCC program access regulations, for as long as those regulations are in place and for as long as News Corp. and Fox hold an interest in DirecTV, as if News Corp. and its subsidiaries were vertically integrated programming vendors. Specifically, News Corp. will continue to make all of its national and regional programming available to all multi-channel distributors on a non-exclusive basis and on non-discriminatory prices, terms and conditions. Neither News Corp. nor DirecTV will discriminate against unaffiliated programming services with respect to the price, terms or conditions of carriage on the DirecTV platform." Fox Entertainment Group Press Release, *"News Corporation Agrees to Obtain 34 percent of Hughes Electronics for $6.6 billion in Cash and Stock."* (Apr. 9, 2003), *http://www.newscorp.com/feg/fegpress/feg*_181.html.

[9] Frank Ahrens, *"Murdoch's DirecTV Deal Scares Rivals."* Washington Post, Apr. 11, 2003.

[10] Bureau of Labor Statistics, Consumer Price Index (March 2003). From 1996 until March 2003, CPI increased 19.3 percent while cable prices rose 50.3 percent, 2.6 times faster than inflation.

[11] Federal Communications Commission, *Ninth Annual Report, In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, MB docket No. 02–145 (Dec. 31, 2002).

[12] Federal Communication Commission, 2001b, p. 20, notes that cable operators in only 330 communities have been granted status as effectively competitive on the basis of overbuilding.

[13] Federal Communications Commission, 2002b, Table C–1.

[14] Kagan, 1998.

[15] Federal Communications Commission, 2002b, p. 31.

[16] Federal Communications Commission, 2002b, p. 20.

[17] Federal Communications Commission, 2001b, p.34, notes increasing urban subscribers, but figures show that satellite is still disproportionately rural.

[18] Rosston and Shelanski, 2002, p. 23, give a hypothetical local market with a cable firm having an 80 percent market share and satellite having 20 percent in

making a point about the impact of concentration in national markets. They never discuss the local HHI, which would be 6800. This meets the antitrust definition of a monopoly.

[19] Report on Cable Industry Prices, February 14, 2002, p. 36.

[20] Report on Cable Industry Prices, February 14, 2001, p. 36.

[21] Pearce, George, The Dictionary of Modern Economics (MIT Press, Cambridge, 1984), p. 94. Cross Elasticity of Demand. The responsiveness of quantity demanded of one good to a change in the price of another good. Where goods i and j are substitutes the cross elasticity will be positive—i.e., a fall in the price of good j will result in a fall in the demand for good i as j is substituted for i. If the goods are complements the cross elasticity will be negative. Where i and j are not related, the cross elasticity will be zero. Taylor, John, B., Economics (Houghton Mifflin, Boston, 1998), p. 59.

A sharp decrease in the price of motor scooters or rollerblades will decrease the demand for bicycles. Why? Because buying these related goods becomes relatively more attractive than buying bicycles. Motor scooters or rollerblades are examples of substitutes for bicycles. A substitute is a good that provides some of the same uses or enjoyment as another good. Butter and margarine are substitutes. In general, the demand for a good will increase if the price of a substitute for the good rises, and the demand for a good will decrease if the price of a substitute falls. Bannock, Graham, R.E. Banock and Evan Davis, Dictionary of Economics (Penguin, London, 1987).

Substitutes. Products that at least partly satisfy the same needs of consumers. Products are defined as substitutes in terms of cross-price effects between them. If, when the price of records goes up, sales of compact discs rise, compact discs are said to be a substitute for records, because consumers can to some extent satisfy the need served by records with compact discs. This account is complicated by the fact that, when the price of an item changes, it affects both the REAL INCOME 01 consumers and the relative prices of different commodities. Strictly, one product is a substitute for another if it enjoys increased demand when the other's prices rises and the consumer's income is raised just enough to compensate for the drop in living standards caused (pp. 390–391).

Cross-price elasticity of demand. The proportionate change in the quantity demanded of one good divided by the proportionate change in the price of another good. If the two goods are SUBSTITUTES (e.g., butter and margarine), this ELASTICITY is positive. For instance, if the price of margarine increases, the demand for butter will increase (p. 99).

[22] Report on Cable Prices, p. 11.

[23] Federal Communications Commission, 2002b.

[24] Federal Communications Commission, 2001b, describes the DBS variable as the level of subscription. Federal Communications Commission, 2002b, uses the DBS dummy variable.

[25] The cluster variable was included in the Federal Communications Commission 2000a and 2001b Price reports. Its behavior contradicted the FCC theory. It has been dropped from the 2002 report. The MSO size was included in the 2002 report. System size has been included in all three reports.

[26] Vertical integration was included in Federal Communications Commission, 2002b.

[27] U.S. General Accounting Office, "*Report to the Subcommittee on Antitrust, Competition, and Business and Consumer Rights, Committee on the Judiciary, U.S. Senate: Issues in Providing Cable and Satellite Television Services."* October 2002. In an important clarifying footnote, the report finds that:

"This was a larger effect than that found by FCC in its 2002 *Report on Cable Industry Prices* (FCC 02–107). Using an econometric model, FCC found that cable prices were about 7 percent lower in franchise areas when there was an overbuilder. One possible explanation for the difference in results is that we conducted further analysis of the competitive status of franchises that were reported by FCC to have an overbuilder. We found several instances where overbuilding may not have existed although FCC reported the presence of an overbuilder, and we found a few cases where overbuilders appeared to exist although FCC had not reported them. We adjusted our measurement of overbuilder status accordingly."

[28] Tom Wolzien, *"Returning Oligopoly of Media Content Threatens Cable's Power."* The Long View, Bernstein Research (Feb. 7, 2003). Emphasis added.

[29] Coalition for Program Diversity, Jan. 28, 2003.

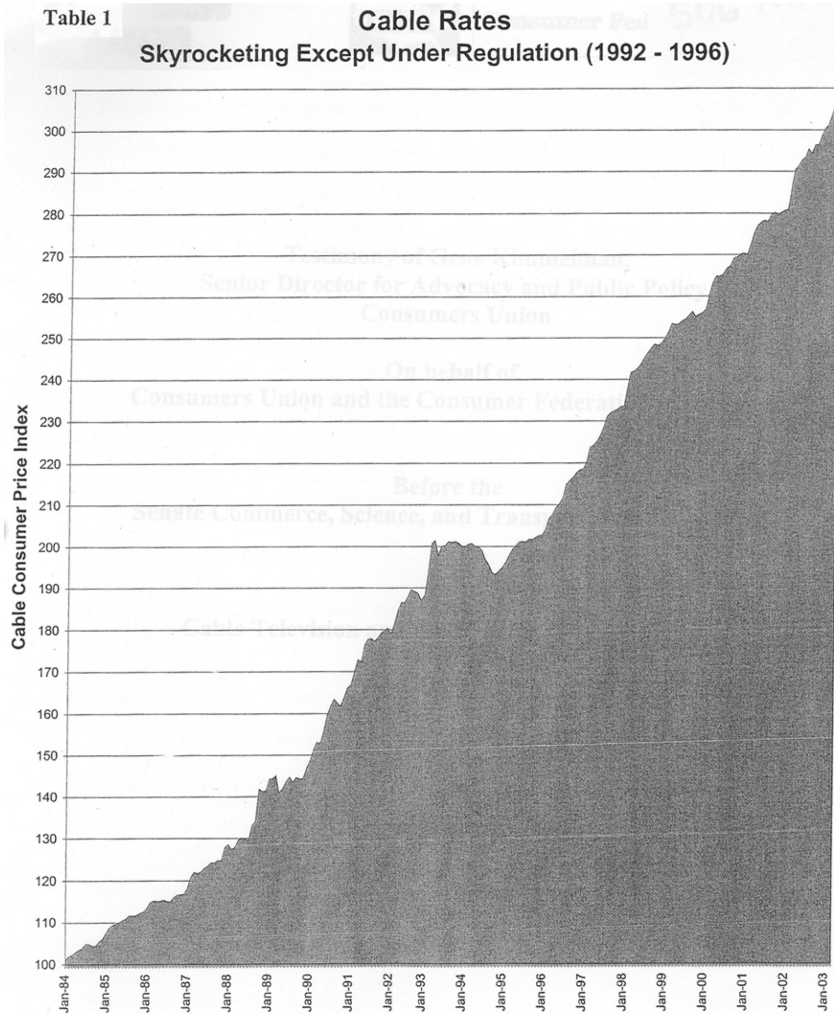
[30] Victoria Riskin, President of Writers Guild of America, West. *Remarks at FCC EnBanc Hearing, Richmond, VA* (Feb. 27, 2003).

[31] Federal Communications Commission, *Ninth Annual Report, In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, MB docket No. 02–145 (Dec. 31, 2002).

[32] One of the more ironic arguments offered by the cable operators feeds off of the observation that broadcast networks have carriage rights. They argue that even if cable operators foreclosed their channels to independent programmers, these programmers could sell to the broadcast networks. This ignores the fact that cable operators control the vast majority of video distribution capacity. There are approximately 60 channels per cable operator on a national average basis (Federal Communications Commission, 2002b, p. 10). There are approximately 8 broadcast stations per DMA on a national average basis (BIA Financial, 2002). Each broadcast station has must carry rights for one station. They can bargain for more, particularly in the digital space, but the cable operators control more stations there as well. In other words, if we foreclose 85 percent of the channels, the programmers will be able to compete to sell to the remaining 15 percent of the channels. Needless to say, this prospect does not excite independent programmers.

[33] Public Law 102–385, Section 2(a)(9).

[34] Public Law 102–385, Section 2(a)(12).



The CHAIRMAN. Thank you.
Mr. Gleason?

STATEMENT OF JAMES M. GLEASON, PRESIDENT AND COO, CABLEDIRECT

Mr. GLEASON. Thank you.

I am the president of CableDirect, an independent cable business serving nearly 20,000 customers in more than 150 rural communities in nine States. I am also the chairman of the American Cable Association, and our members are small and not affiliated with programming suppliers. I also will echo some of the comments you have heard this morning, but I hope I bring them from the perspective of a small operator that is serving more small and rural areas.

Due to the concentration of media ownership, there are really three very important issues that threaten the rural customers. The abusive conduct of a handful of the media conglomerates toward smaller market distributors and their customers, the adverse impact of the proposed FOX, News Corp, DirecTV merger on competition in small and rural markets, and the disproportionate regulatory burdens that I face compared to my satellite competitors.

To begin, the abuse of conduct by a handful of media conglomerates is driving up consumer costs and taking away choice, particularly in small markets. The key question here is, who controls what your constituents see on their TV sets? The answer is these five conglomerates. Over the past 5 years, we have seen the explosion of consolidation in the programming industry that has led to sharply increased prices and reduced consumer choice. As has been mentioned, ESPN's fifth annual rate increase of 20 percent was just announced. The fact is the programming rates for 14 of the major programming networks has risen 67 percent over the last 5 years, an increase of more than five times the consumer price index.

But there is more. As you have heard, in order for us to get ABC or a FOX affiliate, Disney and FOX will often force us, through retransmission consent, to take and pay for other channels we know our customers do not want. The abuse of retransmission consent goes farther. In order to get consent for a local broadcast station in one market, we have to carry satellite programming in other markets where they do not even own the broadcast station.

One solution might be to offer the expensive programming in tiers or a la carte. But all of the programming companies force their programming onto the lowest, most basic levels of service.

The CHAIRMAN. Mr. Gleason, can you document the allegations that you just made?

Mr. GLEASON. Certainly.

The CHAIRMAN. We would appreciate that.

Mr. GLEASON. There is one flaw in what we get into, and, in most of our, if not all of our agreements, have confidentiality clauses which do not allow us to show what we have to do and what we have to comply with and what we have to pay.

The CHAIRMAN. So it would be difficult for you to provide us with documentation.

Mr. GLEASON. It would be very difficult.

[Laughter.]

Senator STEVENS. We could subpoena it.

The CHAIRMAN. Senator Stevens says we could subpoena it, I guess. But those are very serious allegations——

Mr. GLEASON. Yes, they are.

The CHAIRMAN.—Mr. Gleason. Go ahead.

Mr. GLEASON. So to break the stranglehold of programmers and give consumers any choice, we should do three things—ensure the freedom to unbundle programming, revamp the laws dealing with retransmission consent and program access, and require the transparency and disclosure of programming costs. Today, programmers tie and bundle their services in a way to obtain one service, we are forced to pay for other services our customers do not request.

Congress should amend telecommunication laws to provide that no programming provider can require that its services be carried on the basic or expanded basic levels of service. Rather, to give customers choice and allow the market to determine what gets on TV, programmers should be required to make their services available as part of a separate programming tier.

Today, network owners use retransmission consent to tie and bundle their services in a way to force your constituents to pay for channels they do not want. ACA has provided the FCC with extensive evidence of abusive retransmission consent practices and has petitioned for an inquiry into this conduct, and we urge you to request the FCC to take immediate action on the inquiry.

Furthermore, the retransmission consent laws were to put the local broadcasters on a more equal competitive footing with cable. Since then, media consolidation has turned the process on its head. Now the media conglomerates are using retransmission consent to evade market forces in order to artificially inflate their revenues.

In terms of transparency and disclosure, as you mentioned, what consumer, local franchising authority, or your congressional office, knows what it costs to watch TV? The answer is no one. That is because the conglomerates resist the transparency by hiding their practices under the cloak of confidentiality requirements. Congress should amend the Communications Act to require programmers to make annual disclosures to local franchise authorities and the FCC. These disclosures should include what programmers charge cable business and how they mandate bundling or placement of their services. Moreover, Congress should direct the FCC to compile an annual comprehensive programming price index to show how much consumers are truly charged to watch television. The FCC should also compile a retransmission consent index to show consumers what it truly costs to receive their local broadcast stations.

Concerning the merger of FOX, News Corp, and DirecTV, I feel it will create the world's largest vertically integrated programming distributor. This multinational behemoth will control access to programming, limit customer choice, raise programming prices, and eliminate competition in rural markets. Because of these concerns, we believe the government should place strict, easily enforceable conditions on any such merger. In addition, Congress should amend the programming access laws to extend them to vertically integrated satellite entities, just as these laws are applied to vertically integrated cable entities.

And, finally, the smaller independent cable companies face a disproportionate burden of regulation compared to the free regulatory ride enjoyed by the satellite companies. Congress should reduce independent cable's regulatory burden and balance it with satellites.

In conclusion, why should anyone here listen to what we have to say? If Cox and Cablevision feel they have no leverage with programmers, you can imagine the lack of leverage we have as a small cable operator in rural and small markets. The irony here is that the impact of these media ownership issues, if not addressed by Congress, will have the opposite outcome to what Congress desires. The potential outcome will not provide new advanced services, competition, or choice for consumers in small and rural marketplaces.

Thank you.

[The prepared statement of Mr. Gleason follows:]

PREPARED STATEMENT OF JAMES M. GLEASON, PRESIDENT AND COO, CABLEDIRECT

I. Introduction

Thank you, Mr. Chairman.

My name is Jim Gleason, and I am the president and chief operating officer of CableDirect, an independent cable business currently serving 40,000 customers in more than 250 rural communities in nine states—Alabama, Colorado, Illinois, Indiana, Iowa, Mississippi, Missouri, Oklahoma and Texas.

I also serve as the chairman of the American Cable Association, which represents more than 1,000 independent cable businesses serving almost 8 million customers primarily in smaller markets and rural areas across the United States. In fact, our American Cable Association members serve customers in every state and U.S. territory and also in nearly every congressional district.

Unlike big companies you hear about, ACA members are not affiliated with programming suppliers, television networks, big cable, broadcast, satellite and telephone companies, major ISPs or other media conglomerates. We focus on smaller market cable and communications services, often in markets that the bigger companies chose not to serve. Because we live and work in these rural communities, we know how important it is to have advanced telecommunications services available and to be a provider of choice in these communities.

ACA members are leading the industry in delivering advanced services in smaller markets. Far from living on the wrong side of the digital divide, millions of customers served by independent cable companies enjoy access to digital cable and broadband Internet services that are not available in some urban areas. Some ACA member systems have begun to deliver DTV broadcast signals as well, doing our part to move the transition forward. We also look forward to providing newer, advanced services to our customers in rural America too. Advanced services like digital broadcast television, high definition television, video-on-demand and cable and Internet telephony, to name a few.

As you know, most of today's headlines in the communications world are about the large companies, such as the Fox/News Corp./DirecTV merger and the media giants created by the mergers of the 1990s and beyond.

Just for the record, my small company is *not* the "giant entrenched cable monopoly" that others talk about so frequently. Rather, being on this panel makes me feel like a David among many Goliaths. The American Cable Association represents no Goliaths. We're simply small businesses in cable that happen to serve customers in rural America.

We're here to speak for the millions of small-town customers and thousands of small-town businesses that are represented by every Member of this Committee.

Quite frankly and ironically, we're the smaller-market and rural competitor to what may soon become the "giant entrenched, vertically integrated *satellite* conglomerate"—Fox, News Corp., and DirecTV.

I hope my testimony here today will help you serve your constituents by understanding the critical issues facing the multichannel video programming and distribution industry and the negative effects that continue to occur as a result of increasing media consolidation.

These issues will have a significant impact on all Americans and could have a devastating effect on smaller markets and rural communities where our ACA mem-

bers employ thousands and serve millions. I therefore ask for your consideration and hope you will agree that the industry is in need of congressional and regulatory review.

II. Competition and Choice are the Victims of Increasing Concentration of Media Ownership.

To me, the real benefit of this hearing is the opportunity to highlight the current status of customer choice in the multi-video services market, *because competition really means customer choice.* No choice, no competition. However, the irony here is that the status of competition and customer choice today, especially in rural areas and small towns, is already significantly limited because it is governed by an unlikely cast of players that do not live in rural America, do not focus on rural Americans' needs, and who have found anti-competitive means to extract enormous wealth from the pockets of rural consumers and businesses.

Unless there is significant congressional and regulatory review of these issues, the situation is sure to get worse. Consumer choice and competition may be wiped out in the wake of the mergers creating these mighty communications giants. Let me tell you why.

There are three very important issues that threaten consumer choice in smaller markets and rural America and that will derail the progress to provide advanced services in smaller markets:

1. The abusive conduct of a handful of media conglomerates toward smaller market distributors and their customers. The media giants are using their vastly increasing control of content, pricing, terms, conditions and placement requirements to control what the consumer sees and how much he or she pays. The News/Corp. Fox team is near the top of this short list. Congress must act to address the worsening structural programming problems that are forcing consumers to pay more while taking away any choice.

2. The adverse effect of the proposed Fox-News Corp.-DirecTV merger, which will limit current competition in U.S. markets—particularly in smaller and rural markets—by consolidating enormous, vertically-integrated content and control in the hands of one company—the merged Fox/News Corp./DirecTV empire. If this merger is ultimately approved, then at the very least the Federal Communications Commission and Department of Justice must place significant conditions on this merger to ensure fair access to News Corp. affiliated satellite and broadcast programming. The conditions News Corp. have proposed in their first FCC filing fall far short of what is required. But even beyond strict conditions, Congress should also extend and apply current program access laws covering vertically integrated cable operators to vertically integrated satellite operators.

3. The disproportionate burden of regulation on smaller, independent cable companies, like mine in rural America, compared to the free regulatory ride enjoyed by a giant multinational satellite powerhouse. Congress and the FCC must reduce or balance these regulatory burdens with DBS to foster and protect full and fair competition in smaller markets and rural areas.

III. Key Issues

1. The abusive conduct of a handful of media conglomerates is threatening the ability of cable systems, particularly in smaller markets, to compete. More importantly, these abuses are driving consumer costs up while taking away choice. Congress must act to address the worsening structural programming problems caused by increasing media concentration.

From our standpoint, this hearing provides an important and appropriate opportunity to highlight how little customer choice exists today in the multichannel video services market, especially in rural America. The fact is that the status of competition and customer choice today, especially in rural areas and small towns, is already significantly diminished because it is governed by an unlikely cast of players who neither live in rural America, nor focus on its needs.

This unlikely cast includes several major media conglomerates that are mandating the cost and content of most of the services we provide in smaller markets. These include Disney/ABC/ESPN, Fox/News Corp.(DirecTV), General Electric/NBC, CBS Viacom/UPN, and AOL/Time Warner/WB. For smaller market cable systems, this is a fundamental problem that directly impacts our ability to provide a viable, competitive service to our customers. These major media conglomerates, which we call **OPEC, the Organization of Programming Extortion Companies**, have found through media consolidation the means to use market power to extract ever-increasing profits from consumers and businesses in smaller markets.

Unless there is significant congressional and regulatory action to address these issues, the situation will only worsen. Without your intervention, consumer choice and competition, not to mention the deployment of advanced telecommunications services in rural areas, will disappear in the wake of this merger frenzy.

A vitally important question here: Who controls what your constituents see on their TV sets? Not a small cable business like mine or any one of our ACA members. Customers and local franchise authorities are unaware of this, but their television choices are controlled by the five OPEC companies.

Over the past 5 years we have seen an explosive consolidation in the programming industry that has led to sharply increased prices, less freedom to offer popular content, and little customer awareness as to why they are forced to buy the channels they do.

For example, ESPN's fifth 20 percent increase in 5 years was announced just this past week.

Imagine how your Committee would react if it were my cable company or any other cable operator that raised its rates 20 percent a year for 5 years in a row. Frankly, the same indignation you would feel if my company raised rates like this must be focused on ESPN and other programmers, like Fox Sports, that raise rates like this *every year.*

The fact is that programming rates for 14 of the major cable programming networks have risen 66.6 percent over the past 5 years—an increase of more than 5 times the Consumer Price Index (CPI) over the same period.

In ESPN's case, one day after ESPN announced last week its fifth consecutive annual 20 percent increase, ESPN's parent company, Disney, announced a $400 million revenue increase for the 2nd Quarter of 2003, largely attributed to revenue growth at ESPN and other Disney programming networks.

If you want to know why cable rates are increasing, this is a big reason why.

But there's more.

Obviously, some of our customers want ESPN or Fox Sports. But ABC-Disney and Fox/News Corp. will not let us just buy ESPN or Fox Sports. Oftentimes, in order to get the local ABC or Fox affiliate, Disney and Fox will force us through retransmission consent to take and pay for other channels we know our customers don't want.

This abuse of retransmission consent goes farther—in order to get consent to carry a local broadcast station in one market, our members are forced to carry Disney or Fox's satellite programming in other markets, where Disney and Fox do not even own the broadcast station.

For example, is it really in the public interest for all of my customers to pay for recycled soap operas, a programming service for which most of them have absolutely no interest, just so some of my customers can be permitted to watch their ABC affiliate?

Adding to the absurdity of the situation, these conditions for carriage often outlive the terms of the retransmission consent period for the local broadcast station by many years. As a result, these mandated conditions clog a cable system's channel capacity with OPEC programming while denying that capacity to independent, non-OPEC programmers. The end result is that these mandated OPEC conditions increase costs and decrease choice for consumers.

It gets worse. One solution might be to offer the expensive services in tiers or a la carte. This would allow consumers to choose whether or not they wish to pay for the expensive services. But all of the OPEC programming companies force their programming onto the lowest, basic levels of service, making our companies and customers pay for all of their programming whether they want it or not. We must ask: Is this good for the consumer? Is this in the public interest? Is this why these companies get exclusive control over valuable spectrum?

Consolidation has turned retransmission consent into extortion. Even more appalling is that fact that the OPEC companies embed in their contracts various "nondisclosure" terms. These provisions prohibit cable operators from telling any customer, even the local franchise authority or your Committee, the rates and terms for the distribution of the OPEC programming. Thus, rate increases and unfair bundling practices are kept hidden from the public and even from Congress. That is not the foundation for an open, functional and fully competitive marketplace, or one that is transparent and constructed to best serve consumers.

I am sure you all remember the retransmission consent showdown in New York City between Time Warner and Disney over this very issue.

After that enormous struggle between industry titans, imagine the odds a small company like mine has when negotiating with these OPEC programmers.

The five major OPEC programmers control all broadcast networks and at least 50 other of the most popular stations. More than 90 percent of cable systems offer 30–90 channels, which, as you can see, are dominated by OPEC programmers.

In fact, on your own Senate cable system more than 63 percent of the widely distributed channels on it are controlled by the OPEC media conglomerates.

In order to assist your review of this situation, I have attached several charts that depict the realities a member of our association faces with regard to programming and channel capacity. I urge you to review these charts carefully in order to better understand the enormous power held by only a handful of consolidated media conglomerates.

The irony here is that at a time when Congress wants our small cable businesses to provide our customers with *more* choice and *greater* value, media conglomerates like Disney/ABC/ESPN, Fox/News Corp./DirecTV and the other OPEC companies are *restricting choice* and *raising costs.*

If our smaller businesses and our customers are ever to regain any measure of control over the spiraling rates imposed by these voracious conglomerates, then Congress must intervene.

The members of the American Cable Association and independent cable's buying group, the National Cable Television Cooperative, have for years sought meaningful dialogue with the OPEC programmers, but to no avail.

More than a decade of debate and discussion on these issues with them has led to no positive change in their behavior.

To break the stranglehold of control by the OPEC programmers and to give consumers and independent cable businesses any choice and control, Congress should act in three specific areas:

- ensure the freedom to unbundle OPEC programming;
- revamp the laws dealing with retransmission consent and program access; and,
- require the transparency and disclosure of programming costs.

Unbundling: Today the OPEC programmers tie and bundle their services in such a way that to obtain one service our customers are forced to pay for other services they don't want.

Congress should act to ensure that the programming conglomerates cannot force consumers and cable businesses to take bundled services or require that these services be carried on the lowest levels of service.

If the programming conglomerates had exercised any self-control to stop this conduct, we wouldn't be here today asking Congress to act. But the abuse goes on.

Congress should amend telecommunications laws to provide that no programming provider can require that its services be carried only on the basic or expanded basic level of service. Rather, to give consumers choice and to allow the market to determine what gets on TV, programmers should be required to make their services available as part of a separate programming tier, or even a la carte.

The template for this congressional action has already been created. Both Mr. Dolan and Mr. Hindery on this panel and their respective companies, Cablevision Systems and the Yankees Entertainment Service (YES), are now allowing consumers to buy higher-priced programming services on either a tier or as a single, a la carte channel.

And the consumers' call for more choice through tiering and a la carte has been heard by more than just ACA. The Chairman of this Committee has called for such change, which has been supported by several larger cable companies as well.

However, this fundamental change to give consumers more choice through tiering and a la carte will not occur without congressional action.

In the case of Cablevision and YES, it took the actions and efforts of the New Jersey Senate, U.S. Senator Frank Lautenberg, New York City Mayor Michael Bloomberg and New York State Attorney General Elliott Spitzer to compel this result.

If it takes this kind of combined political pressure to force parties of *equal* bargaining power together, what likelihood do consumers in smaller markets and rural areas have to see the same changes without congressional action. Frankly, none.

Therefore, Congress must help us give consumers greater choice by amending the Communications Act to allow us the right to offer all programming on a tiered or a la carte basis.

Retransmission Consent: Today, as a result of unprecedented media consolidation, the OPEC programmers abuse retransmission consent laws simply to line their pockets. They do this by forcing your constituents to pay for unwanted programming in exchange for receiving their local, free over-the-air broadcast stations.

ACA has provided detailed evidence of these abuses to the Federal Communications Commission and has *asked the FCC to undertake an inquiry into these abusive retransmission consent practices. The FCC has so far not acted on this petition. We ask the Congress to urge the FCC to take immediate action on this inquiry.*

The retransmission consent laws when enacted in 1992 were designed to put local broadcasters on a more equal competitive footing with cable operators. Since then, unforeseen media consolidation has turned this process on its head. Now, the media conglomerates are using the retransmission consent laws to evade market forces in order to artificially inflate the revenues from their satellite programmers. The practical impact of this evasion by the media conglomerates is that rural and smaller market consumers have less choice and higher costs, effectively subsidizing urban markets.

Congress should amend the retransmission consent laws to protect our consumers from being forced to pay for unwanted satellite programming just to see their local broadcast stations.

Transparency and Disclosure: What consumer, local franchising authority or congressional office knows what it costs to watch TV? The answer is not one. That's because the OPEC conglomerates resist transparency by hiding their abusive practices under the cloak of confidentiality requirements.

Who gets the blame when programmers force unpopular or costly programming on our basic tiers? Not them, but us.

As ESPN's fifth consecutive 20 percent annual increase shows, programming prices continue to escalate far in excess of the rate of inflation, raking in enormous sums from consumers. It's greed run amok. One way to rein in the greed of programmers is to require transparency.

Congress should amend the Communications Act to require programmers to make annual disclosures to local franchise authorities and the Federal Communications Commission. These disclosures should include what programmers charge cable businesses and how they mandate bundling or placement of their services.

Moreover, *Congress should direct the FCC to compile every year a comprehensive Programming Price Index to show Congress and consumers how much they are truly being charged to watch television. Every 3 years the FCC should also compile and publish a Retransmission Consent Index to show consumers what it truly costs them to receive their local network television stations.*

Until there is transparency in the programming marketplace, consumers and their local providers of service will have little control over what is seen on TV, when it is seen on TV, or how much it will cost.

2. The adverse effect of the proposed Fox-News Corp.-DirecTV merger will limit current competition and choice in U.S. markets—particularly in smaller and rural markets. The Federal Communications Commission and Department of Justice must place significant conditions on this merger, and Congress should also extend and apply current program access laws to vertically integrated satellite operators.

Customers will also face less choice as a result of the vertically integrated satellite conglomerate that would be created from a Fox-News Corp.-DirecTV merger.

The merger of Fox, News Corp. and DirecTV will create perhaps the world's largest vertically integrated programming distributor. This multi-national behemoth will possess global reach and control a television broadcast network, scores of broadcast affiliates, a significant number of cable and satellite programming channels, and a complete satellite distribution system with DirecTV's more than 10 million customers. These facts alone will give Fox the ability to control access to programming, limit customer choice, raise programming prices, and eliminate competition in rural markets.

The threat by a merged Fox/News Corp./DirecTV to use its programming leverage against other competitors is not theoretical. Upon completion of the merger, the conglomerate will have exclusive control over certain sporting events, including the NFL's Sunday Ticket and numerous regional sports networks.

Last Friday, News Corp. proposed some "voluntary conditions" in its first FCC filing on the merger. These do not go nearly far enough. Even with the proposed conditions, News Corp. and its many broadcast and programming affiliates will still have an arsenal to increase costs and reduce choice for rural consumers.

Because of these concerns, we believe the government must place strict and easily enforceable conditions on any such merger. In addition, Congress should amend the program access laws to extend them to vertically integrated satellite entities, just like these laws are applied to vertically integrated cable entities.

3. Smaller, independent cable companies face a disproportionate burden of regulation, compared to the free regulatory ride enjoyed by the giant satellite companies. Congress should reduce independent cable's regulatory burden or balance it with satellite's.

We continually hear representatives of the direct broadcast satellite industry say how Congress should help DBS compete against the "giant, cable monopoly" by reducing or eliminating the DBS regulatory burden.

However, contrary to these DBS cries, two facts are clear:

First, as we have already outlined, the new Fox/News Corp./DirecTV juggernaut will assemble an unparalleled array of content and distribution assets. Absent clear enforceable restrictions, the conglomerate will expand the use of this massive power to the detriment of choice, competition and consumers in rural America.

Second, my company and the nearly 1,000 other small, independent cable businesses in the American Cable Association are obviously not the "cable giants" that DBS says it must compete against. Rather, we are and will be the competitor in smaller markets and rural areas. That's why preserving competition in rural markets is vital.

But it's more than that. Right now direct broadcast satellite enjoys favored regulatory treatment that gives it a great advantage in the rural marketplace. Consider the following list and ask if this regulatory balance is fair. The average ACA member company serves 8,000 subscribers, more than 9,992,000 *fewer* subscribers than the post-merger DirecTV. Fox and DirecTV cannot seriously maintain that they need governmental help to compete against smaller market cable companies.

Regulatory Burdens

Small Cable (Avg. 8,000 Subscribers)	Fox/DirecTV (10,000,000 Subscribers)
Must-Carry in all Markets	Must-Carry only in selected markets
Retransmission Consent	Retransmission Consent
Emergency Alert Requirements	Limited Public Interest Obligations
Tier Buy-Through	
Franchise Fees	
Local Taxes	
Signal Leakage/CLI	
Rate Regulation	
Mandatory Carriage of Broadcast on Basic	
Privacy Obligations	
Customer Service Obligations	
Public Interest Obligations	
Service Notice Provisions	
Closed Captioning	
Billing Requirements	
Pole Attachment Fees	
Public File Requirements	

In smaller markets and rural areas, the regulatory disparity that exists between independent cable and DBS must be addressed if Congress and federal policymakers want to ensure that multiple providers of video service are there to provide choice to consumers. This means that Congress should reduce, or at least equalize, the regulatory burdens on smaller cable.

IV. Conclusion

Each one of the foregoing issues directly affects the market's ability to: (1) provide competition and choice in smaller markets; (2) give consumers control over what they see on television and how much they pay for it; and, (3) deploy advanced new services in rural communities.

My company and the members of the American Cable Association are here today alongside the giants of the television, cable, satellite and telecommunications world. Why should anyone here listen to what we have to say?

Because the nature of our businesses makes us uniquely sensitive to the needs of small and rural markets. We serve nearly 8 million consumers in nearly all congressional districts and, in fact, every state represented on this Committee.

The irony here is that the impact of these media ownership issues, if not addressed by Congress, will have the opposite outcome to what Congress desires. This potential outcome will not provide advanced new services, competition and choice for consumers in the smaller and rural marketplaces.

The American Cable Association and its members are committed to working with the Committee to solve these important issues.

I would like to sincerely thank the Committee again for allowing me to speak before you today.

Exhibits

1. "Who Controls Your TV Set?"
2. U.S. Senate Channel Card
3. ACA Member Programming Pie Chart
4. ACA Member Programming Bar Chart
5. ACA Letter to Sen. McCain on media ownership, cable rates and programming increases; March 19, 2003

Must Take TV

Who Controls Your TV Set?

Did you know that more often than not, if you want one of these channels you **MUST** take the whole package?

CBS/VIACOM/UPN (15):
*BET *TVLand *TNN *Comedy *VH1 *MTV2 *Sundance *Noggin
*BETJazz *CMT *TMC *Flix *MTV *Showtime *Nickelodeon

AOL/Time Warner/WB (12):
*Cartoon *Cinemax *CNN *Boomerang *Turner Classic *Turner South
*CourtTV *HBO *Headline News *TBS *TNT *CNNI

GE/NBC (10):
*AMC *Bravo *CNBC *History *A&E
*MSNBC *Paxson *Telemundo *ShopNBC *Biography

NEWS CORP/FOX/DirecTV (10):
*Fx *FxM *FoxNews *Golf *Fox Kids *National Geographic
*FoxSportsNet *FoxSports World *HealthNet *SpeedVsn

Disney/ABC/ESPN (10):
*Lifetime *ABC Family *ESPN *ESPN News *Toon Disney
*Disney Channel *ESPN Desportes *ESPN2 *ESPN Classic *SoapNet

Front

U.S. Capitol Cable System

Senate Channel Lineup

2	Republican Policy Committee
3	C-SPAN
4	WRC – NBC Washington (General Electric)
5	Senate Recording Studio
6	Democratic Policy Committee
7	WJLA – ABC Washington (Disney/ESPN)
8	C-SPAN2
9	WUSA – CBS Washington (Viacom)
10	CNN (AOL Time Warner)
11	Local Programs – Committee Hearings
12	Local Programs – Committee Hearings
13	Local Programs – Committee Hearings
14	Local Programs – Committee Hearings
15	Local Programs – Committee Hearings/Univision (Spanish)
16	CNBC/PM News - ABC-TV Baltimore (GE & Disney/ESPN)
17	MSNBC (General Electric)
18	WTTG – FOX Washington (News Corp/DirecTV)
20	C-SPAN 3
21	WETA – PBS Washington
22	NASA / WJZ – CBS Baltimore (Viacom)
23	WHMM – PBS Washington
24	FOX News (News Corp/DirecTV)
25	Senate Recording Studio/Multicast News
26	Bloomberg TV
27	WPIX – WB New York (AOL Time Warner)
28	News Channel 8 – IND Washington
30	Weather Channel / PM News/NBC Balt. (General Electric)
34	ESPN – Sports Network (Disney/ESPN)
35	CNN Headline News (AOL Time Warner)
36	WTBS – Independent Atlanta (AOL Time Warner)

14 of 22 widely distributed channels are owned by media conglomerates! More than 63%!

www.americancable.org

Back

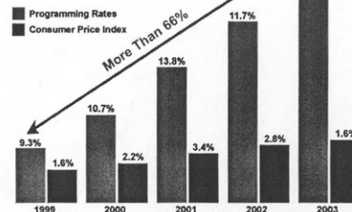
Media Conglomerates Control Your Dial!

★ More than 63% of Senate channel lineup is controlled by five media conglomerates!

★ Media conglomerates tie, bundle and hold programming hostage through retransmission consent, taking away consumer choice and forcing cable rates up.

★ Major media conglomerates -- Disney/ABC/ESPN; CBS/Viacom/UPN; General Electric/NBC; NewsCorp./Fox/DirecTV; AOL Time Warner/WB.

Programming Rates vs. CPI



★ Programming costs for 14 top cable networks have risen 66.6% over the past five years—an increase of more than 5 times the Consumer Price Index.

★ According to the U.S. Department of Labor, the Consumer Price Index has risen 12.1% over the same period.

★ Enormous programming rate increases by media conglomerates are aimed at smaller, rural cable businesses and their customers.

About the ACA

The American Cable Association represents the sole voice of independent cable television businesses working in smaller towns and rural America. ACA has represented independent cable since 1993 when these businesses joined together to create their own voice in Washington.

ACA represents more than 1,000 independent businesses that serve nearly seven million customers in small towns and rural areas all across America. Virtually all of ACA's members live and work in areas across the so-called "digital divide."

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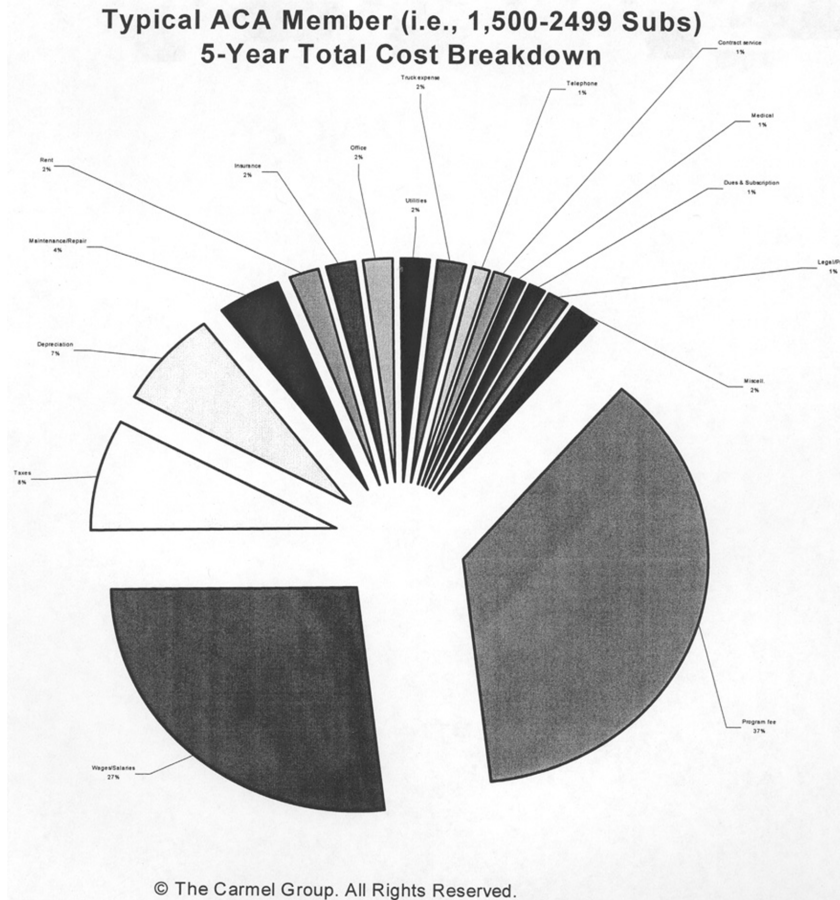

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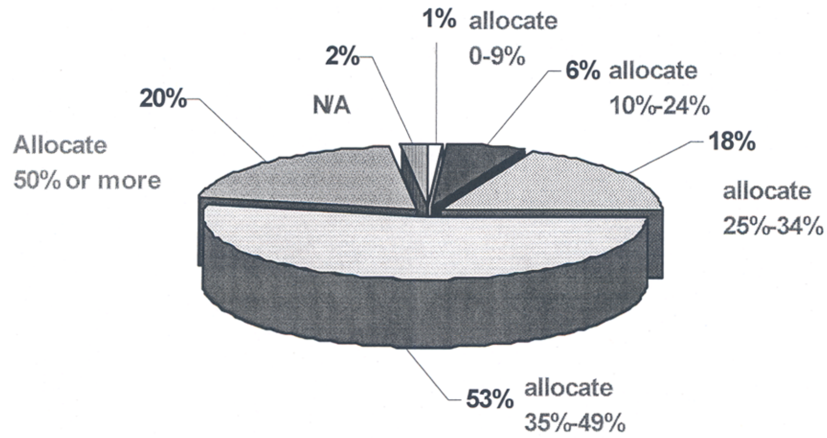
ACA Members' % of Total Expenses Allocated to Programming



N/A = data not available

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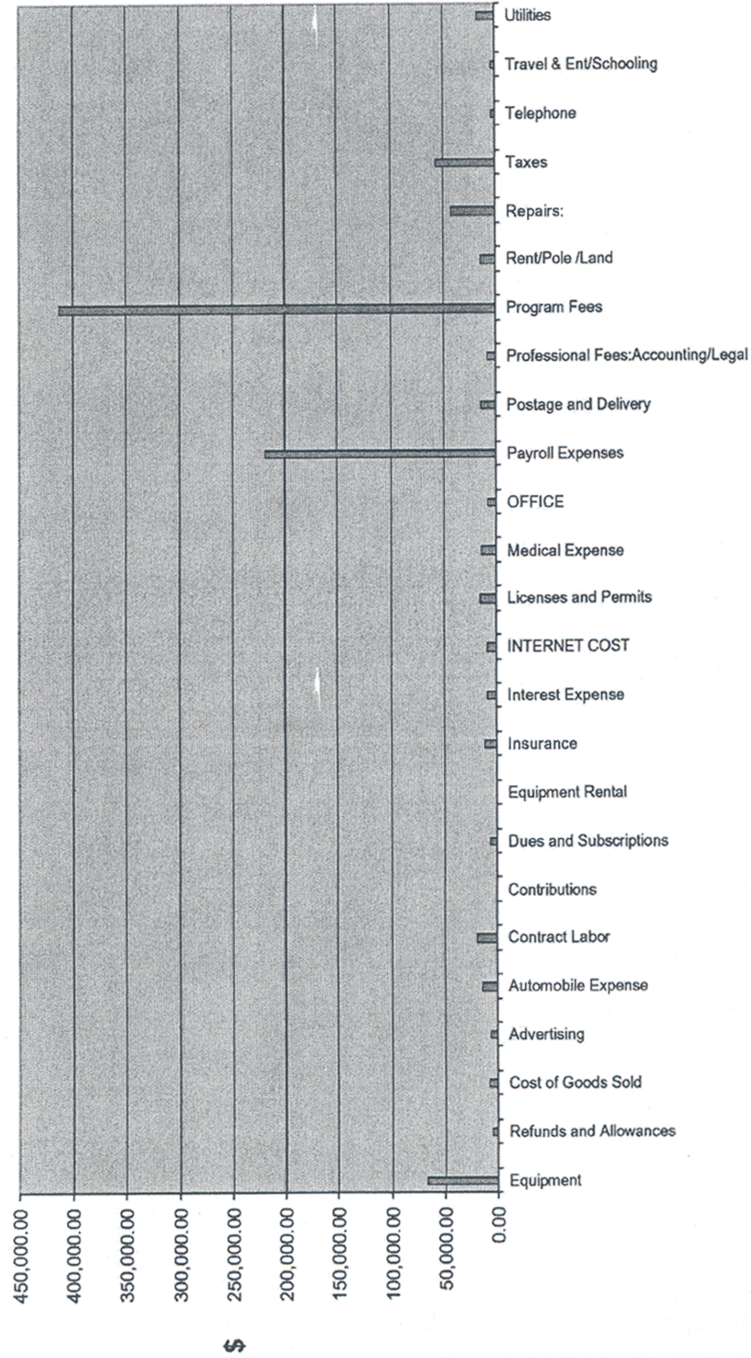
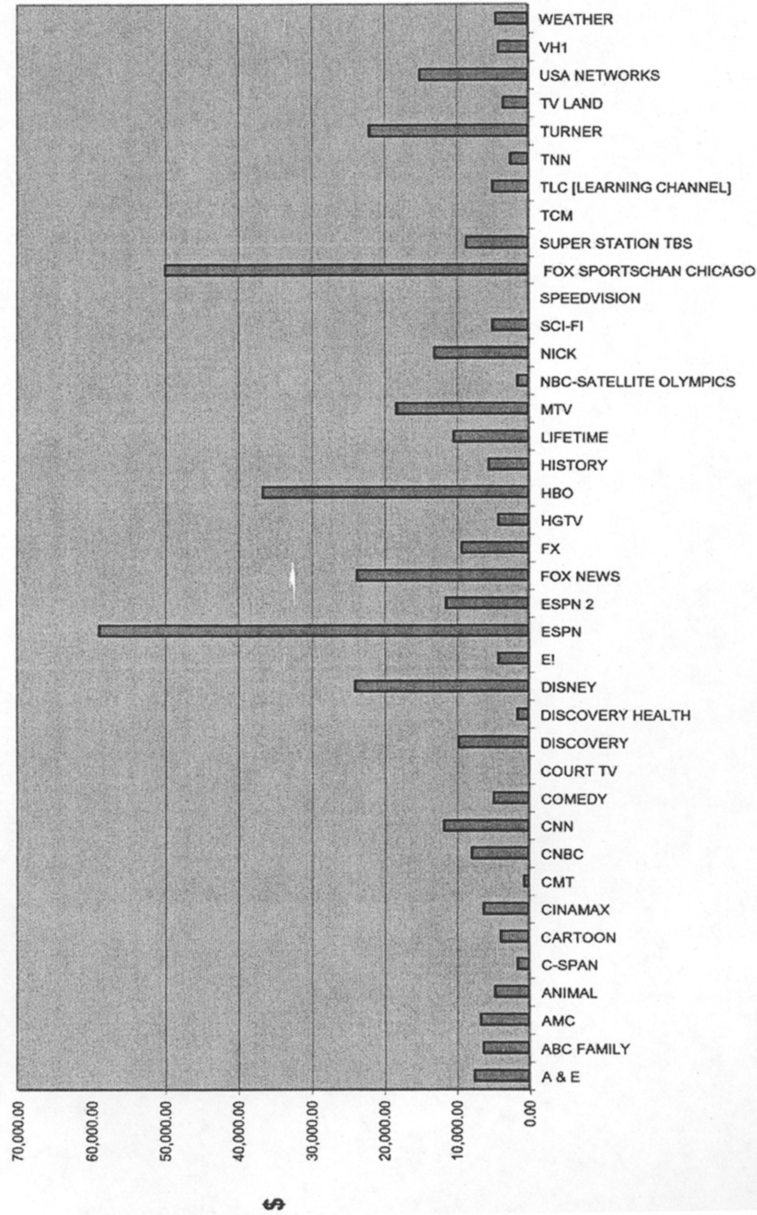

Typical ACA Member (1,500 - 2, 499 Subs) 2002 Total Costs
Utilities
Travel & Ent/Schooling
Telephone
Taxes
Repairs:
Rent/Pole /Land
Program Fees
Professional Fees:Accounting/Legal
Postage and Delivery
Payroll Expenses
OFFICE
Medical Expense
Licenses and Permits
INTERNET COST
Interest Expense
Insurance
Equipment Rental
Dues and Subscriptions
Contributions
Contract Labor
Automobile Expense
Advertising
Cost of Goods Sold
Refunds and Allowances
Equipment
450,000.00
400,000.00
350,000.00
300,000.00
250,000.00
200,000.00
150,000.00
100,000.00
50,000.00
0.00
$


Typical ACA Member (1,500 - 2, 499 Subs) 2002 Total Programming Costs
$
70,000.00
60,000.00
50,000.00
40,000.00
30,000.00
20,000.00
10,000.00
0.00
A & E
ABC FAMILY
AMC
ANIMAL
C-SPAN
CARTOON
CINAMAX
CMT
CNBC
CNN
COMEDY
COURT TV
DISCOVERY
DISCOVERY HEALTH
DISNEY
E!
ESPN
ESPN 2
FOX NEWS
FX
HGTV
HBO
HISTORY
LIFETIME
MTV
NBC-SATELLITE OLYMPICS
NICK
SCI-FI
SPEEDVISION
FOX SPORTSCHAN CHICAGO
SUPER STATION TBS
TCM
TLC [LEARNING CHANNEL]
TNN
TURNER
TV LAND
USA NETWORKS
VH1
WEATHER

AMERICAN CABLE ASSOCIATION
Pittsburgh, PA, March 19, 2003

Hon. JOHN MCCAIN,
Chairman,
Senate Committee on Commerce, Science, and Transportation,
Washington, DC.

Dear Chairman McCain:

On behalf of the nearly 1,000 independent cable business members of the American Cable Association, I want to endorse the comments you made in your January 14, 2003 Commerce Committee hearing on the state of competition in the telecommunications industry. There is no question that the unprecedented consolidation of media ownership in the programming industry has driven up cable rates to our members' cable customers.

Higher Costs and Loss of Consumer Choice From The Mega-Mergers

Our Association has been in the forefront of resisting mega-mergers that have led to higher programming costs for our customers. Since 1995 at the FCC, FTC and Department of Justice, ACA has strenuously objected to the mergers of Disney and ABC (ESPN), Time Warner and Turner, Viacom and CBS. We predicted that permitting these combinations would lead to higher programming costs and reduced consumer choice. As you and others have noted, this is exactly what has happened.

The effect of these mergers and media consolidation has been to put massive control of content and distribution into the hands of just a few—Disney/ABC, Fox/News Corp., General Electric/NBC and CBS/Viacom. In turn, the media conglomerates have used their content control and leverage to drive programming rates, and thus cable rates, up, while at the same time consumers, particularly in smaller markets and rural areas, have lost any choice in the price and package of services they receive.

Currently, these conglomerates enjoy unfettered control to force their affiliated programming and ever-increasing programming rates on smaller cable operators and consumers.

The Latest Example: Retransmission Consent Abuses

The latest example of the way in which concentration of ownership is pushing up cable rates is in broadcaster retransmission consent. For smaller cable operators and smaller market consumers, retransmission consent has become a vise. On one side of the vise are a handful of media conglomerates—Disney, Fox, Hearst-Argyle, Gannett, and a few others—with ever-increasing demands. On the other side are retransmission consent laws and outdated FCC market protection regulations. Squeezed in the middle are smaller cable operators and consumers.

As a result, small cable companies and small market consumers must pay far more than their big city/big cable counterparts for access to local broadcast signals. The higher costs come in two forms. First are retransmission consent tying arrangements. To obtain access to a local network signal, Disney, Fox, Hearst-Argyle and other media conglomerates force carriage of, and payment for, affiliated satellite programming that neither consumers nor cable operators requested. Second, in this most recent round, cash-for-carriage demands have proliferated. The broadcaster affiliates of these conglomerates demand tying arrangements or sham cash "alternatives" of on average $0.70 per customer per month. Gannett and Cox Broadcasting are demanding strictly cash for carriage, take it or leave it.

The Exploitation By Programming Conglomerates of Smaller Markets

The quest by consolidated media owners for new revenue streams from smaller markets has washed away any pretense of localism. *Smaller market consumers are the losers.*

This problem draws a bright line between big and small. First, this is a distinctly small cable problem. The big cable multiple system operators, with millions of customers and a range of other negotiation advantages, reportedly are receiving consent to carry local signals with little fanfare.[1] Not so for smaller cable operators. Second, this is big broadcaster problem. When dealing with independent broadcasters and small affiliate groups, ACA members report mutually beneficial carriage arrangements. In short, *a few media conglomerates are exploiting hundreds of smaller cable companies and millions of rural consumers.*

[1] *Most Cable MSOs Get Deals Done on Retransmission Consent,* Communications Daily (January 10, 2003).

In this retransmission consent round, in growing numbers, small cable operators are concluding that neither their businesses nor their customers can support the retransmission consent demands of the media conglomerates. This simply results in higher costs to their customers *for nothing new.* The broadcasters are withholding consent. *Signals are being dropped in market after market.* The consequence of these abuses of retransmission consent is either higher cable rates or loss of broadcast service. This cannot possibly be the outcome desired by leaders like you.

Remedies Are Possible

As you are aware, one large-market cable MSO, Cablevision, settled a yearlong carriage dispute with the YES Network. YES demanded that the only way their network could be carried by Cablevision was on the basic level. This would have forced all Cablevision customers to pay for YES, whether or not they wanted to receive it. Cablevision said "No." The result was New York City area cable subscribers did not receive approximately 120 Yankee games last year. Cablevision and YES settled the dispute by allowing the MSO to put the Yankees' games on a new sports tier *and* offer YES as an *a la carte* option.

Cablevision said it is working to ensure that those who choose to receive sports services bear the cost, and those who do not are not forced to pay, thus aligning sports costs to consumer value.

While this agreement is great news for consumers in the New York City area, it highlights how big MSO's are treated differently than smaller cable operators.

The ACA agrees with your March 14, 2003, letter to the five CEO's of the largest cable companies where you challenged these operators to follow Cablevision's lead and provide their customers with similar choices, especially with respect to the most expensive programming services, like sports, that continue to drive up cable rates.

All cable operators should have the ability to place programming on a tier or offer a la carte where cable customers can decide how best to spend their money according to their own interests and choices. But unless cable operators have big market leverage, like Cablevision, programmers—particularly the sports programmers—won't give them that right.

Cable companies in smaller markets simply do not have the market leverage to negotiate the best deals for their customers. Programmers continuously turn a deaf ear to the needs of rural America. They simply *refuse to negotiate* agreements similar to the Cablevision/YES deal.

I agree with you that the Cablevision deal is not a complete solution to the problem of skyrocketing programming rates, but it is an important first step to lowering cable rates by providing consumers with more choice. And this step must be expanded to all cable consumers and operators.

The ACA Response

ACA has recently filed Reply Comments in the media ownership proceeding at the FCC with substantial evidence of pervasive exploitation of retransmission consent in smaller markets and the harm to the public interest in localism, choice, and reasonable rates for basic cable. ACA has also filed an urgent Petition for Inquiry into Retransmission Consent Practices.[2] These filings contain numerous examples of retransmission consent abuse by the programming conglomerates. So far, the Commission has not acted on these filings.

ACA also strongly believes that programmers must be *required* to make their programming available to *all* consumers on a tiered or a la carte basis. We believe Congress must act to require this or the result will be that smaller market and rural consumers will have no chance to take advantage of the consumer benefits Cablevision was able to achieve.

Further Action on Media Concentration

I urge that you, as Commerce Committee Chairman, take the lead in examining the egregious impact that media concentration has had on cable rates, particularly in the smaller markets of this country.

Furthermore, I urge you and your Committee to explore and investigate how consumers and their providers can be given more choice in how programming services are priced, packaged and provided, without the enormous leverage of the media conglomerates, whose actions have driven programming and cable rates skyward without check.

ACA stands ready to assist in this effort in any way.

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[2] *Petition for Inquiry into Retransmission Consent Practices,* American Cable Association (filed October 1, 2002) ("Petition for Inquiry"); *Petition for Inquiry into Retransmission Consent Practices, First Supplement*, American Cable Association (filed December 9, 2002) ("Supplement").

Most respectfully yours,

MATTHEW M. POLKA

The CHAIRMAN. Thank you, Mr. Gleason.

For the record, Mr. Murdoch was invited to testify here today, and he was unable to because of scheduling.

Mr. Hindery?

STATEMENT OF LEO HINDERY, JR., CHAIRMAN AND CEO, YES NETWORK

Mr. HINDERY. Good morning to you, Mr. Chairman, and to your fellow Senators.

I am Leo Hindery. I am the chairman and CEO of the YES Network, which is a regional sports network that I formed in September 2001 to serve New York, Connecticut, and parts of New Jersey and Pennsylvania. YES has acquired, as its most notable programming, the long-term broadcast rights of the New York Yankees, the New Jersey Nets and the English football club, Manchester United, together with Big East and Ivy League conference sports.

At its launch in March 2002, YES had negotiated long-term carriage agreements with DirecTV and with 36 of the region's 37 cable operators. The only cable operator which did not agree to carry YES was the company Cablevision, the largest cable operator in our region, which also, notably, owns the area's only other regional sports networks and which previously owned the broadcast rights of the Yankees and the Nets. It took a federal antitrust suit, legislative initiatives throughout the area, especially in New Jersey, and several consumer lawsuits to finally convince Cablevision to carry YES, after a year of saying "no way" to us and to its customers.

I am honored to have testified in front of this Committee, Mr. Chairman, numerous times over the past 15 years on the subjects of cable-industry regulation, cable rates, programming issues, and industry consolidation. Prior to founding YES, I was, as some of you may recall, CEO of AT&T Broadband and of its predecessor company, TCI.

When I testified here in the past, I commented to the Senators that additional cable-industry regulation would probably not be required. Notably, I also promised, at least for the companies I managed, that customers should expect cable rate increases which would approximate general inflation, that consolidation would bring noticeable benefits to consumers, and that my company would never abuse its enormous market powers to the detriment of independent programmers. I believe the record will show that when I was around, TCI, and later AT&T, I kept those promises.

Sadly, however, I find myself today deeply concerned about the future of independent programmers which do not have ready access to multichannel distributors simply because they are not vertically integrated. And I find it beyond irresponsible for cable industry leaders to blame programmers for their often excessive rate increases when the overall facts clearly belie this contention, and especially when more than half the channels—half the channels—available to consumers are actually owned by cable companies. I would also point out that more than half of the regional sports net-

works in the country are also owned by someone in the cable industry, including Cablevision and Cox.

In 1974, 30 years ago, President Gerald Ford appointed a high-level Cabinet Committee to develop proposals for a new policy that would allow cable to be integrated into our Nation's communication media. Recommendation No. 1, recommendation No. 1 from the Committee, concluded that, "Control of cable distribution should be separated from control of programming and other services provided over the channels on those distribution facilities."

Notably, this recommendation was made fully a decade before the dramatic proliferation of cable-industry-owned programming services. And after reading all of the Committee's background materials, it is certainly clear that no one on that Committee contemplated a world like we have today, where, every day, independent programmers are held hostage by large, multichannel operators which either own numerous and significant competing programming services or which, through consolidation, have accumulated extraordinary amounts of market power. And they certainly did not envision a world, Mr. Chairman, where only seven cable companies, as you commented, would control access to more than 90 percent of the Nation's homes, and the largest would alone, access 40 percent.

I have testified in front of you often in support of vertical integration and in support of cable-industry consolidation, and I would do so again today, if asked. And my testimony would reiterate the economies of scale which consumers should realize from consolidation, and it would reiterate that vertical integration can be a very positive force in the launch of new programming services.

However, I no longer believe that additional regulation is uncalled for. Rather, I request that you pass, in the form of a short amendment to Section 616 of the Communications Act, legislation which will assure the vitality of independent programmers and assure that vertical integration will cease to be a discrimination tool for the Nation's larger cable operators.

The cable-industry consolidation genie is out of the bottle, and he is not going back in; nor do I, personally, believe he should. However, I do believe that, as first contemplated by the Ford Committee 30 years ago, program access must now be embedded by legislation and by regulation into the operating practices of the cable industry.

The reason I do not include the satellite-broadcast industry in this recommendation is that, with sensitivity, News Corp has already committed to full program access as a precondition to its pending acquisition of DirecTV. But now it is truly the cable industry's turn to fully embrace program access.

Specifically, I am requesting that this Committee preserve the existence of independent, unaffiliated programmers and assure the vitality of all programming by incorporating three principles into Section 616 of the Communications Act.

Those principles, which can be addressed with only a handful of additional words, are, first, there must be parity or nondiscrimination in the way programming services are treated, regardless of ownership. This extends to wholesale prices, to packaging, to consumers, and to positioning on the dial. In other words, a multi-

channel video-programming distributor should not be able to engage in conduct the effect of which is to restrain the ability of an unaffiliated video-programming vendor to compete fairly.

Second, all programmers should receive the fair market value of their programming, regardless of whether or not the programming service is affiliated or unaffiliated. Nothing more, but certainly nothing less.

Third, cable operators must now make decisions related to program acquisitions, to pricing of programming to customers, and to packaging in a truly content-neutral manner. Content neutrality, as we all know, is, of course, a basic First Amendment principle in media. But if it is not made part of the proposed amendment to the Communications Act, then the reality is that any large cable operator, vertically integrated or not, can use the existing state of play, wherein so very many of the existing channels are already owned by companies in the cable industry, to thwart opportunities for independent, nonaffiliated programmers.

In closing, Mr. Chairman, I would comment that no one really knows how multichannel television will continue to evolve, which is why the continuing oversight of this Committee and of the FCC is so vital. But we do know that today only a handful of cable companies control access to more than 90 percent of the Nation's television households, that today more than half the channels available on the dial are owned by a company affiliated with the cable industry, and that every day independent nonaffiliated programmers, small and big alike, are discriminated against.

We also know, from early firsthand experiences, that some of the cable industry's recent undertakings in the areas of packaging and bundling actually conspire to significantly further restrict consumer choice and access to unaffiliated independent video and now Internet services.

It is time, Mr. Chairman, I believe, for the content playing field to be leveled, as first addressed by the Ford Committee, and for vertical integration to cease to be an opportunity for discrimination.

Thank you all for your courtesy.

[The prepared statement of Mr. Hindery follows:]

PREPARED STATEMENT OF LEO HINDERY, JR., CHAIRMAN AND CEO, YES NETWORK

Good morning to you, Mr. Chairman, and to your fellow Senators.

I am Leo Hindery, and I am chairman and CEO of the YES Network, which is a regional sports network that I formed in September 2001 to serve New York, Connecticut, and parts of New Jersey and Pennsylvania. YES has acquired, as its most notable programming, the long-term broadcast rights of the New York Yankees, the New Jersey Nets and the English football club Manchester United, together with Big East and Ivy League conference sports. At its launch in March 2002, YES had negotiated long-term carriage agreements with DirecTV and with 36 of the region's 37 cable operators. The only cable operator which did not agree to carry YES was the company Cablevision, the largest cable operator in our region which also, notably, owns the area's only other regional sports networks and which previously owned the broadcast rights of the Yankees and the Nets. It took a federal antitrust suit, legislative initiatives throughout the area, especially in New Jersey, and several consumer lawsuits to finally convince Cablevision to carry YES, after a year of saying "no way" to us and to its customers.

I am honored to have testified in front of this Committee numerous times over the past 15 years, on the subjects of cable industry regulation, cable rates, program-

ming issues, and industry consolidation. Prior to founding YES, I was, as some of you may recall, CEO of AT&T Broadband and of its predecessor company, TCI.

When I testified here in the past, I commented to the Senators that additional cable industry regulation would probably not be required. Notably, I also promised, at least for the companies I managed, that customers should expect cable rate increases which would approximate general inflation, that consolidation would bring noticeable benefits to consumers, and that my company would never abuse its enormous market powers to the detriment of independent programmers. I believe the record will show that when I was around, TCI and later AT&T kept those promises.

Sadly, however, I find myself today deeply concerned about the future of independent programmers which do not have ready access to multi-channel distribution simply because they are not vertically integrated. And I find it beyond irresponsible for cable industry leaders to blame programmers for their often excessive rate increases, when the facts clearly belie this contention and especially when more than half of the channels available to consumers are actually owned by cable companies.

In 1974, thirty years ago, President Gerald Ford appointed a high-level Cabinet Committee to develop proposals "for a new policy that [would] allow cable to be integrated into our Nation's communications media." Recommendation number 1 from the Committee concluded that "control of cable distribution should be separated from control of programming and other services provided over the channels on those distribution facilities." Notably, this recommendation was made fully a decade before the dramatic proliferation of cable industry-owned programming services. And after reading the Committee's background materials, it is certainly clear that no one on the Committee contemplated a world like we have today, where every day independent programmers are held hostage by large multi-channel operators which either own numerous and significant competing programming services or which through consolidation have accumulated extraordinary amounts of market power. And they certainly did not envision a world where only seven cable companies would control access to more than 90 percent of the Nation's homes and the largest would alone access 40 percent.

I have testified often in support of vertical integration and in support of cable industry consolidation, and I would do so again today if asked. And my testimony would reiterate the economies of scale which consumers should realize from consolidation, and it would reiterate that vertical integration can be a very positive force in the launch of new programming services.

However, I no longer believe that additional regulation is uncalled for. Rather, I request that you pass, in the form of a short amendment to Section 616 of the Communications Act, legislation which will assure the vitality of independent programmers and assure that vertical integration will cease to be a discrimination tool for the Nation's larger cable operators.

Much like the unwanted spam which Senators Burns and Wyden have taken bold steps to eliminate, every day viewers in America are forced to watch programming owned by the distributor which brings them the programming, rather than receiving programming which is not influenced by who owns it. The issues are substantially the same.

The cable industry consolidation genie is out of the bottle, and he isn't going back in. Nor do I believe he should. However, I do believe, that as first contemplated by the Ford Committee thirty years ago, "program access" must now be embedded, by legislation and by regulation, into the operating practices of the cable industry. The reason I do not include the satellite broadcast industry in this recommendation is that, with prescient sensitivity, News Corp. has already committed to full "program access" as a precondition to its pending acquisition of DirecTV. But now, it truly is the cable industry's turn to fully embrace "program access."

Specifically, I am requesting that this Committee preserve the existence of independent, unaffiliated programmers and assure the vitality of all programming by incorporating three principles into Section 616 of the Communications Act. Those principles, which can be addressed with only a handful of additional words, are:

> *First*, there must be "parity", or nondiscrimination, in the way programming services are treated, regardless of ownership. This extends to wholesale prices, packaging to consumers and positioning on the dial. In other words, as first raised by the Ford Committee and later codified in part in the Communications Act, a multichannel video programming distributor should not be able to engage "in conduct the effect of which is to restrain the ability of an unaffiliated video programming vendor to compete fairly."
>
> *Second*, all programmers should receive the fair market value of their programming, regardless of whether or not the programming service is affiliated or unaffiliated. Nothing more, but certainly nothing less.

> *Third*, cable operators must make decisions related to program acquisitions, to pricing of programming to customers, and to packaging in a truly content neutral manner. Content neutrality is, of course, a basic First Amendment principle in media, but if it is not made part of the proposed amendment to the Communications Act, then the reality is that any large cable operator, vertically integrated or not, can use the existing state of play, wherein so very many of the existing channels are already owned by companies in the cable industry, to thwart opportunities for independent, nonaffiliated programmers.

In closing, I would comment that no one really knows the way multi-channel television will continue to evolve, which is why the continuing oversight of this Committee and of the FCC is so vital. But we do know that today only a handful of cable companies control access to more than 90 percent of the Nation's television households, that today more than half of the channels available on the dial are owned by a company affiliated with the cable industry, and that every day independent, nonaffiliated programmers, small and big alike, are discriminated against. We also know from early first-hand experiences that some of the cable industry's recent undertakings in the areas of packaging and bundling actually conspire to significantly restrict consumer choice and access to unaffiliated, independent video and Internet services. It is time, I believe, for the content playing field to be leveled, as first commented on by the Ford Committee, and for vertical integration to cease to be an opportunity for discrimination.

Thank you for your courtesy.

The CHAIRMAN. Thank you, Mr. Hindery. Can you document that every day independent nonaffiliated programmers, small and big, are discriminated against?

Mr. HINDERY. I can. I can, Mr. Chairman. And it is a perilous path for some, because, if you have been discriminated against, when you raise your head, as you know, it sometimes gets lopped off. I have commented to some that I think the only reason that the YES fight was able to rise to the visibility it did and to the success it did was it was regionally contained. But there are people, Senator, who will stand in front of you and your fellow Senators and back up those assertions.

The CHAIRMAN. If you could provide that for the Committee, those instances and individuals, I would appreciate it.

Mr. Robbins, do you want to respond to that?

Mr. ROBBINS. Mr. Chairman, I would just suggest one missing point here. The issue that I am here to speak to is the combination of high price and broadly mandated distribution in programming offerings, and that is what has happened in the sports world. My issue is, let us go to a tier, let us let the consumer choose whether they want to pay for that high-priced service or not. It is no more complicated than that.

The CHAIRMAN. Well, could you respond to the allegation that every day independent nonaffiliated programmers, small and big, are discriminated against?

Mr. ROBBINS. I do not think I can, because we give fair hearing to every programmer that comes along, where we have reasonable business relationships. We accommodate those issues and those channels get carriage.

The CHAIRMAN. Thank you.

Mr. Robbins and the members of the panel, do you believe that a la carte or multi-tiered pricing would benefit consumers? And if you think so, do you believe that Congress should mandate it? Beginning with you, Mr. Robbins. I think I know your answer to the first part of it.

Mr. ROBBINS. Well, my answer is, I would like to see the marketplace work. And if the marketplace is not working, then we are in a position where we are going to have a train wreck. And I would not like to see a train wreck.

The CHAIRMAN. Mr. Dolan?

Mr. DOLAN. Well, I agree with Mr. Robbins' comments on that. I think it really begins with the program vendors. If the program vendors are prevented from denying their programming to the cable operator, unless he requires all of his customers to buy that programming, you have immediately set the market free. I think that is the fundamental difficulty that we have at this time.

And if I understood the General Accounting Office testimony this morning, the increase in cable prices—in our case, of our operating expenses, 55 percent of them are due to programming—if we are unable to control those costs, we are also unable to control the price that we will need to charge our customers for that programming if we are to remain in business.

The CHAIRMAN. Thank you.

Mr. Kimmelman?

Mr. KIMMELMAN. I heard Mr. Gleason say before that programmers have too much leverage. I think he is right. But I believe these gentlemen to my left, cable operators, have too much leverage, as well. This should be consumer leverage, not industry leverage. This should be choice. I suggest——

The CHAIRMAN. Since half the channels are owned by cable operators.

Mr. KIMMELMAN. Absolutely right. And I believe the FCC data show—I am not clear what it will show in terms of intent, but the FCC data show that cable companies that own programming tend to carry their own programming, to the disadvantage of independent entities that have similar programming, not surprisingly.

I would suggest, Mr. Chairman, that cable companies will assert their First Amendment right to put on whatever programming they like, and I think that is fair, but I do believe it would be appropriate to balance this with Congress requiring them to unbundle their programming and, at the same time, do approximately what Mr. Hindery is asking for. Let us get rid of discrimination in how the bundles are put together. Let us get rid of any discrimination and favoritism in how the programming is put together. Let us unbundle it all the way across the board and give consumers control of what they want.

The CHAIRMAN. Mr. Gleason?

Mr. GLEASON. Yes, I think we have got to be able to tier cable programming, particularly with the escalation in costs. Yes, we are a cable operator, as well, but no one in our organization or myself owns any of the cable programming, so we are at a vast disadvantage when it comes to being able to decide what we are going to carry.

To Mr. Hindery's comments on discrimination, I do not know if it is necessarily discriminatory or not, but I can, to a certain extent, agree with the independent programmers in that many times when we have to sign a programming agreement for one service of the major media conglomerates, we have got to agree to carry four, five, six, seven different services that they offer in order to get the

service that has the highest ratings that our customers really desire. So I think when that happens and it fills up our dial, yes, it does make less room for independent programmers.

Mr. HINDERY. Mr. Chairman, briefly, I think there is such commonality among Mr. Kimmelman, Mr. Gleason, and myself. It can be handled so simply with this concept of parity, that you are treated fairly regardless of who owns you, and you are treated the same regardless of what you broadcast.

The concern I had throughout the YES fight was the ongoing hypocrisy of the industry. Half of the regional sports networks in the country owned by the industry, including some of these gentlemen carried in basic, contractually mandated that we were highlighted outside of that milieu. One was even formed by one of these companies while we were having the fight in New York. It is the hypocrisy of the industry that has grown to distress me so, and that speeches are given against programmers every day, except their own. Practices are forced down programmers' throats, except their own.

And it is a very simple fix, Mr. Chairman. It is a few words that simply says "parity," as President Ford contemplated nearly 30 years ago, "content neutrality," and, to Mr. Gleason's comment, "fair market value of programming." No programmer should ask for more or less than that. And it would all level out. Much of the abuse that has crept into the system would all level out if those three principles were commonly embraced.

The CHAIRMAN. Thank you. My time has expired.

Senator Wyden?

Senator WYDEN. Thank you, Mr. Chairman.

A question, if I might, for you, Mr. Kimmelman, but perhaps some of the other witnesses want to get into this, as well. I mean, what we have established in the course of the morning is that broadcasters own lots of cable channels. No question there. And cable companies, in effect, own many others. And my concern is, if the FCC now lifts the limits on ownership, all of the problems that have been established with respect to these cross-ownership interests are going to get worse.

Mr. Kimmelman, do you share that view? And any of the other panel members are welcome to come in.

Mr. KIMMELMAN. Absolutely, Senator Wyden. I think it is going to hit in two major forms. One is price, the most obvious one, that if you have market power and you can bundle your programming, you are going to keep driving the prices up. As we relax ownership rules across media, as well, and we allow more broadcast and cable combinations, now satellite and broadcast with the News Corp deal, you can leverage against one medium your strength in another market. So we are going to see price increases.

But, even more importantly than that, we have seen those before, we are going to see a few national companies with an opportunity to own more local properties, more local broadcast stations, possibly the largest newspaper in a community, and this is not a huge problem, maybe, in terms of national news or international news; we have plenty of competition in that realm. But in the local market, think about it, for 70 percent of the communities in the country, there is only one local newspaper. And for most others,

there are, at best, two. That is where most people get their news and information. If we put that in the hands of one company, it may be a benevolent, positive entrepreneur, and it may not be, and it certainly will not be a watchdog on its own business interests.

Senator WYDEN. Let me ask a question of the cable operators. Long-distance telephone rates have come down. Now, your rates are going up. And you all have said that it is because of investments that you are making in your network and various issues with respect to programming. But I would like to know at what point are you all going to turn to the question the consumers are talking about now, and that is holding the rates down?

Mr. DOLAN. Well, long-distance telephone rates, they—long-distance people have no content costs, no programming costs. It is strictly the cost of operating their facility that they need to reflect in their prices. That is very different from a cable system, which, as I mentioned before, its principal cost is content, and it does not control those content costs.

I think it is interesting that there is as much concern as I have heard this morning about cable control of programming in this market. You know, our company, Cablevision, has over 3 million subscribers in one market. That is more than anybody else has in a single market. And, accordingly, we should have more leverage to accomplish that control than anybody else; but yet of over 200 programming services that Cablevision carries, we own ten.

Senator WYDEN. But the point is, in the technology business, where there is competition, costs and rates go down, and you are still not responding to the question. I want to know when you all are going to turn to the issue of trying to drive these rates down, because everybody else in the technology business, where you see some competition, seems to be going the other way.

Mr. DOLAN. Well, sir, I think that is the happy subject of this meeting today. We think the best way to reduce rates for the customer is to let the customer choose for himself what programming he will buy and what programming he will not buy. If he finds the programming to be not of value and overpriced, he will not buy it. And we all know that that is the way the market works. If it is not of value and overpriced, then either that supplier will not be there for long or he will reduce his price.

Senator WYDEN. I have been saying the a la carte concept and the idea of letting them tailor their desires for cable makes sense. I am just concerned, with all these cross-ownership interests, if you all do not get at the question of bringing these rates down, there is going to be some other way in which these rates continue to soar, and you still have not responded to the question, other than to say that everybody else should be part of the solution.

Sir?

Mr. ROBBINS. Senator Wyden, I am sorry, I want you to know that, in the telephone business, our rates are 10 percent lower than the incumbent operator on a first line. They are anywhere from 30 to 50 percent lower on the second line. Our highspeed data offering is at a higher speed than the telephone companies have offered, and at a lower price until some very recent price announcements were made last week. So I submit to you that we, in fact, have taken the price lead on those services.

Senator WYDEN. All right.

Mr. Kimmelman, one last question, if I might. What kind of safeguards should there be to make sure that there are some checks and balances? I mean, you have got the prospect of more consolidation, more mergers, and cable companies with extensive interests in a whole host of medias. And, again, it just looks virtually unfettered and unchecked. So you have any ideas with respect to safeguards you would recommend?

Mr. KIMMELMAN. Absolutely, Senator Wyden. Let me first say that a la carte is a step forward, but let us remember here that it does not eliminate market power.

Senator WYDEN. That is the point.

Mr. KIMMELMAN. It is still a price set by a cable operator and in negotiations with some very powerful programmers. So there would be more choice. I am not sure it gets at lower prices.

On the safeguards issue, we think the FCC should be very cautious here and not relax its media-ownership rules as it relates to broadcast television and newspapers, particularly in light of the News Corp/DirecTV merger. We are going to ask the Justice Department to look at retransmission consent for News Corp, to look at its ability to leverage over the cable industry and over the—one other satellite company. There are a variety of safeguards that need to be put in place. And I believe, in general, Mr. Hindery is right, there are a number of legislative changes in law that would be very beneficial at this point.

Senator WYDEN. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Stevens?

Senator STEVENS. Thank you very much.

I am interested in what you just said, Mr. Robbins, about your rates being 10 percent lower than the telephone service. But you do not pay Universal Service. Nine percent of their cost is Universal Service. You are not paying Universal Service costs.

Mr. ROBBINS. Yes, we are. We are a full participant in the Universal Service Fund on our telephone revenues, Senator. I am glad you raised that, because I did want to correct that information.

Senator STEVENS. That is not my information at all.

Mr. ROBBINS. Well, I will be happy to——

Senator STEVENS. I will be glad to have evidence to establish that.

Mr. ROBBINS. I will be happy to submit all of the filings that we have made and make sure that record is very clear.

Senator STEVENS. Our information from the FCC does not agree with you, but I will be glad to go into that at another time.

Mr. ROBBINS. I am very certain on that subject, Senator.

Senator STEVENS. I am told when that goes through the Internet, you do not pay.

Mr. ROBBINS. We pay on telephone service into the Universal Service fund, phone-to-phone service. We have almost 800,000——

Senator STEVENS. But if you go through the Internet and go long distance through Internet, you do not pay. Is that right?

Mr. ROBBINS. That is a much more complicated question. We are paying where we do phone-to-phone service.

Senator STEVENS. I am told that that is not true on cable modem. I do not want to spend a lot of time on that, but I would like to

see you clarify that. But I do not think that the Universal Service concept can exist, can continue, unless both the direct broadcaster and your concept of Internet through cable make the contributions required for other providers.

Mr. ROBBINS. Well, we have been an early participant from the beginning in our telephone service.

Senator STEVENS. I am talking about Internet access through—telephony through Internet.

Mr. ROBBINS. I understand, and that is a much more complicated issue. I would be very happy to submit——

Senator STEVENS. You have got 1.6 million highspeed Internet customers now. If they are all using telephony through the Internet, you are not contributing to Universal Service.

Mr. ROBBINS. I say, again, Senator, and I am sorry. We are contributing on our phone service; we are not contributing on our Internet service.

Senator STEVENS. Well, I think we ought to go into that sometime and find out how we are going to have the Universal Service survive in view of these new access concepts to long distance.

Let me go into something else for each one of you, though. The Basic Cable Act requires that each cable operator provide a cable system that has a basic service tier. You do provide that, do you not? Basic tier? Both——

Mr. ROBBINS. Yes, sir.

Senator STEVENS. And you determine what is in the tier, right? There are some requirements by law, as Mr. Dolan has mentioned, signals such as the low power and educational system in any public education with government access program required by a franchise that cable system provide other subscribers, but basically you each determine what the basic tier is, and that is available primarily for people who cannot afford anything else, right?

Mr. ROBBINS. Yes, sir.

Senator STEVENS. Now, beyond that, the law says that you can provide additional signals, and those additional signals are determined by you, right?

Mr. ROBBINS. The expanded basic service, which is above the basic package, yes, sir.

Senator STEVENS. Right. But now I am hearing that the cable systems would like some regulation from Congress to make certain that some of these portions that you previously have included can be separated out, such as ESPN. Is that right?

Mr. ROBBINS. I am only——

Senator STEVENS. Am I hearing right? You are coming to us asking us for more regulation?

Mr. ROBBINS. I did not state—I was quite clear in saying—I thought I was clear; and if not, I want to be very clear now—that I would like this to work itself out in the marketplace. I am not asking for government regulation. But I am suggesting that when services like ESPN get over a dollar, at the wholesale level, per month, then the consumer be given the opportunity to choose whether or not they want that and price it accordingly.

Senator STEVENS. Well, I do not want to be too simplistic, but you own the pipe, and you can determine what goes into the pipe.

Why can you not have 100 different tiers? You can determine that right now without any government regulation, can you not?

Mr. ROBBINS. Yes and no, Senator. The technological limitations on the equipment that we have allow you to tier some services, not all, today. Now, Mr. Dolan has a broader view of that, I think, than I do.

Mr. DOLAN. It is, Senator, very difficult—it is impossible to tier the systems, to tier the expensive programs. You have ESPN saying to us that, "You cannot have ESPN, you cannot carry it on your cable system unless you carry it in your expanded basic service," which is the lowest tier available to the subscriber. So, therefore, they are saying, "Unless your require all of your subscribers to buy our service—do not offer it to them for any choice—all of them must buy it regardless of their interest or lack of interest in sports. And if you do not agree to that, you cannot have that service on your cable system."

Senator STEVENS. But your simple answer is, you can offer individual tiers right now. You can say, "OK, if you do not want to give it to us the way we say, we are not going to carry you."

Mr. DOLAN. We could say that, sir, but the ESPN, MTV, CNN, the YES Network, they all have their constituencies, and if you take that position with that supplier and the effect is to deny that programming to your market, your cable system is going to be in trouble. The customer does not want to hear that you have some quarrel with your supplier and, therefore, they cannot have that programming.

Senator STEVENS. Well, I am sorry I do not have enough time. Mr. Hindery, I particularly appreciated some of the quotes I have read of you in your past positions with regard to the impact of the newly negotiated contracts in the sports field. We are all talking about the problem of increasing costs, but clearly those people in the sports field are entering contracts with players that are far beyond anyone's imagination 5, 10 years ago. I think we have to get into that sometime.

But the difficulty that I have is—for instance, I am told by my staff that programming costs as a percentage of Cox revenues actually declined from 23 percent to 21 percent last year, while programming costs as a percentage of Cox's costs have gone down from 39 percent to 32 percent last year. That seems to indicate that 68 percent of the costs that Cox has right now has nothing to do with programming.

Mr. ROBBINS. Senator——

Senator STEVENS. And yet you are asking us to relieve you from the costs of programming. Now, if 68 percent of your cost is not effected by those programs, such as ESPN, why are you here asking us to give you greater powers?

Mr. ROBBINS. Senator, I am here to try and make clear on the video side of our business—the numbers that you have there have to do with our overall revenues—our telephone business, our highspeed Internet business, our video business—and obviously they have taken the program costs as a percentage of those overall revenues. I think the way that apples should be compared to apples is the program costs should be compared to the video revenues. And video revenues as a percentage—I am sorry, video costs as a

percentage of revenues have gone from 12 percent to 30 percent over the last 5 years of our video costs. So I just—we are mixing apples and oranges with the numbers, Senator.

Senator STEVENS. Well, again, I am out of time, but my staff also advised me the FCC figures show that your cable profit margin hovers between 30 and 40 percent. Despite the economy, despite the recession, your profits are going up. And you are coming here to complain about paying someone else more money.

Mr. ROBBINS. Senator, I am not complaining. I am trying to demonstrate the conundrum that we have with high-priced sports programs and mandatory broad carriage. That is the single issue that is driving video-programming rates, which was what this hearing was called for. And I have been trying to make that point clear, I guess, unsuccessfully, and I apologize.

Senator STEVENS. No, no.

Mr. ROBBINS. That is the connection that I am——

Senator STEVENS. No apology is required. I think we have got such a complex question here, I wish we could have even more time, Mr. Chairman. I would like to——

Mr. DOLAN. Mr. Chairman, may I add a comment?

Senator STEVENS.—visit with you more. I thank you very much for your statement. And I have watched you through your steps through the industry, and I think you have a background we should rely on heavily because of your experience on all facets of this industry.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Mr. Dolan, you wanted to comment?

Mr. DOLAN. Yes, if I just may add to that. The question of cable profits, that really ought to be examined. I hope the GAO will do that. In our case, we have been in business for 30 years, and we are hopeful that our first profit will occur next year. And we are not here really to ask you to give the cable company any more power. I think both Mr. Robbins and I are asking you to give the cable customer more power.

The CHAIRMAN. Mr. Hindery, do you want to respond?

Mr. HINDERY. I have got to tell you, Mr. Chairman, that a business that does not make a profit in 30 years——

[Laughter.]

Mr. HINDERY.—and they are still flying here in the airplane, it is not a bad business.

[Laughter.]

Mr. HINDERY. You know, you cannot—to Senator Stevens' comment, Mr. Chairman, you cannot lay the blame for rate increases on programmers like this industry is trying to do today. Senator Stevens was right, I gave many speeches saying that exorbitant rate increases should not be tolerated in this industry or in any industry. But it is a phantom, a phantom, to blame on programmers these continuing rate increases far, far in excess, as you pointed out in your opening statement, of general inflation. And we have got to get down to the nub, which is fairness.

You cannot have more than 50 percent of the signals, Mr. Chairman, be owned by the industry and then have them blame programming. You know, I met you recently at an event, and I said,

"You know, it is sort of like the old Pogo thing, I met the enemy and it is me." It is either one way or it is the other way.

And it is that hypocrisy that is just rankling, which is—abusive practices by any vendor should be curtailed. But to blame the programming industry for these rate increases is simply wrong. The numbers belie that, and the GAO report is heading in that direction, Mr. Chairman.

And there are a lot of wonderful things that could happen to improve, as Mr. Kimmelman said, the rights and role of the consumer in this debate. But it is not sitting here blaming ESPN. That is not—that is just smoke and mirrors, Mr. Chairman.

The CHAIRMAN. Mr. Gleason and Mr. Kimmelman, this is an equal-opportunity committee.

[Laughter.]

Mr. GLEASON. Well, from the small guys sitting here, I feel like I am in my typical position. We have got the big guys sitting down here at the end saying that it is programming's fault, and I actually do sympathize with them. We have got Mr. Hindery over here on the programming end now saying, well, it is not really the programmers, because it is the big programmers that are owned by the industry. And we find ourselves, as the small cable operators here, in neither one of these positions. Yet I can tell you that due to the drastic programming increases, that is why our retail rates are going up. We rely, in the small end of the business, more heavily on our video end of the business.

Mr. Robbins is exactly right. They are developing new revenue streams in telephony and whatnot, and we are rolling out highspeed data and digital services as rapidly as we can, but the fact of the matter is, in rural America, we rely more heavily still on our basic cable service for our revenue streams. And when we see costs, wholesale costs, go up 16 percent—in ESPN's case, 20 percent a year—there is nothing we can do but to raise rates.

Additionally, if I can respond to Senator Stevens' comments, he said, "Do you choose what we put on our most basic lineup?" The answer, to a certain extent, is no. Our programming contracts require us to put certain programmers—in fact, most of them—on certain levels of service.

So, for example, if we decided for a—let us say we wanted to put The Weather Channel on our most basic lineup, and I have heard Senator Burns say before that is a pretty important thing out where we live. Out in the places of the country we live in, the weather is an important thing.

We cannot do that. Our other programming contracts say, "No, if you put The Weather Channel down there, then you have got to put me down there." So we say, "Well, we cannot do it." Even if our customers tell us they would like to have The Weather Channel on our lowest, most basic form of service. So, therefore, we put them on expanded basic. And then everybody says, "Well, we have got to be on expanded. If you are going to put weather there, we have got to be on expanded."

So here is how this goes. And we, as the smaller operators, do not have the leverage of any of these people here to make any of these drastic changes that need to happen in our industry to control retail rates.

The CHAIRMAN. Mr. Kimmelman?

Mr. KIMMELMAN. Gosh, I always wished I could do play by play. Here is my take on it. The cable industry is, “Please help us. Please help us. We are raising rates too much. The marketplace is not working right. Blame the programmers.” They were given the right to do whatever they wanted except for one thing, carry local broadcast signals and public access on the basic tier. They can put anything else in it they want, or not put it in if they want.

The CHAIRMAN. So they should not be able to demand of Mr. Gleason that he put certain things in any tier.

Mr. KIMMELMAN. Well, what they are saying is, “The market is making me do this. Please help.” Well, there is power in certain programming. It is very popular. People do not want to watch the Super Bowl 3 weeks later. They want to watch it when it happens. They want to watch the World Series when it happens. That yields market power, and the same for popular programming. They do not like the fact that they have to pay a lot to the programmer, but somehow they find a way to just pass it along to the consumer anyway.

I sympathize with the small cable company that does not have all the same revenue streams from other services. And yet what we find is, as they upgrade to digital and as they provide cable-modem service all over the same plant, 20, 30, 40 percent of their customers are taking it yielding a new revenue stream. You have got to look at that revenue stream, and you have got to look at the increased advertising revenue that comes in to offset the cost of programming.

So I think we have got quite a game going on here with nobody putting everything on the table.

Mr. HINDERY. Could I just offer—I totally sympathize——

The CHAIRMAN. I apologize, Senator Lautenberg.

[Laughter.]

Mr. HINDERY. I totally sympathize with Mr. Gleason, who sits out in rural America with small systems that just are in the video business. The fundamental premise, Mr. Chairman, is that 90 percent of the Nation’s homes are now owned by seven companies. With all respect to Mr. Gleason, his problems are real, and they need to be addressed, much like Senator Stevens often tries for his constituents in Alaska, and Senator Burns. But 90 percent of the Nation’s homes are owned by seven companies that own all of this content. It is not Mr. Gleason’s issue to solve; nor is it mine. It rests, with all respect, down there.

Senator STEVENS. Well, I just wish I was back practicing antitrust law. I think I would own one of your networks, because there are some antitrust violations going on here. That is all there is to it.

[Laughter.]

The CHAIRMAN. Mr. Robbins, you should be eligible for a response, and then we will go on.

Mr. ROBBINS. Well, I would take exception to the statistics that Mr. Hindery pointed out. The Disney company is one, Viacom is another, that is not in the distribution business. So I do not know where this enormous amount of leverage that Mr. Hindery is talking about is coming from.

Anyway, let me stop there.

Mr. DOLAN. Well, Mr. Hindery routinely finds us to be masters of monopoly and hypocrisy, and I do not agree with him about that. But I do agree with him that the nub of this meeting is fairness, and if, as Mr. Hindery asserts, that there is no problem with the price of programming, then there should be no problem with letting the subscriber choose whether or not to buy that programming at the price that is asked by Mr. Hindery and by others.

The CHAIRMAN. Well, then I would say that we would hope, then, that there would be no confidential agreements that required Mr. Gleason to carry certain programs on the basic tier.

I want to thank Senator Lautenberg for his patience. This, I think, was a very important discussion.

Senator LAUTENBERG. I agree. Mr. Chairman——

The CHAIRMAN. I thank Senator Lautenberg.

Senator LAUTENBERG.—no problem, because I think a lot of interesting information was brought out in that exchange, and often we do not have interesting information.

[Laughter.]

Senator LAUTENBERG. So it is kind of nice to watch them duke it out here, but it would be nice to also be able to get to the truth.

Mr. Hindery, you took exception to Mr. Dolan's statement about the first profit coming out his business in 30 years, and that is—do the Devils make the profit? Do you know?

Mr. HINDERY. Sadly, the Devils make absolutely no profit, Senator, as you know.

Senator LAUTENBERG. Well, it is then—so the same scorn that you applied to Mr. Dolan's business acumen applies to the—how about the Nets?

Mr. HINDERY. The Nets are marginally profitable, Senator.

Senator LAUTENBERG. Well, my former business partners owned a big piece of that, as you know.

Mr. HINDERY. Yes, I know. They——

Senator LAUTENBERG. And they always——

Mr. HINDERY.—the playoffs.

Senator LAUTENBERG.—complained about not being able to make any money there.

But that is not the issue. I think the issue is somewhat in definitions here. I would recommend that the operators use the terminology other than "expanded basic." It is basic or it ain't. And if it is not, then call it something else, because I think there is a kind of a marketing disguise in there. Nothing evil, but it may be good marketing.

Mr. Gleason, you said that you "sympathize" with the operators, your term. Do you believe what they said? That is a little bit different than "sympathize" with the impact of the programmers?

Mr. GLEASON. I sympathize with the large cable operators?

Senator LAUTENBERG. Yes, you said that.

Mr. GLEASON. I do. I——

Senator LAUTENBERG. Yes, but do you believe—you have heard two of the larger folks talk here about their business—do you believe what they said?

Mr. GLEASON. Yes.

Senator LAUTENBERG. So it is not just sympathy. I mean, you believe——

Mr. GLEASON. Our business——

Senator LAUTENBERG.—that the programmers are taking an inordinate share and exercising special muscle to get that.

Mr. GLEASON. I definitely agree with that, and I agree with Mr. Hindery, in that many of the cable channels that exercise those same kinds of controls are owned by larger cable operators and——

Senator LAUTENBERG. You said that.

Mr. GLEASON.—I agree with Mr. Robbins that both Disney and Viacom also are in the same boat and behave the same way. But, to a certain degree, we are all treated with that same broad brush of tying and retransmission-consent tying and whatnot.

The only assertion that I would make is that when it comes down to companies in the American Cable Association, we do not have the leverage that the big guys would have.

Senator LAUTENBERG. Yes, I understand.

I would ask Mr. Hindery what took so long—since I have a real parochial interest here in New Jersey with the YES Network—what took so long to get this problem ironed out, your agreement with Cablevision and——

Mr. HINDERY. I think what took so long, Senator—and you certainly were in the middle of it being from New Jersey—what took so long is YES came into the market and simply asked that it be treated similarly by Cablevision, as Cablevision treated its own services. Cablevision owns MSG and FOX Sports New York, which it mandates be carried in basic throughout the New York area. It paid itself for those services on basic and was proposing a different treatment for YES. It is that inequity that caused a year to go by.

We had no interest——

Senator LAUTENBERG. Can I preserve my time and just ask Mr. Dolan to respond?

Mr. HINDERY. Certainly, Senator.

Mr. DOLAN. Well, that is just not accurate, sir. I think Cablevision is doing more a la carte programming than most in the industry. I think we have had some kind of a leadership position in that.

As to the particular programming to which Mr. Hindery refers, two thirds of our subscribers, up until this year, had the choice of buying MSG and the FOX network, our two sports channels, on an a la carte basis. Only one third had it embedded in expanded basic. I am sorry about those terms. And the reason for that is that our company has been assembled over a period of time through acquisitions, and we have different technological stages of development, et cetera. The transition is not easy. It is slow. It is painstaking.

But today, all of our subscribers can buy any of those services a la carte.

Senator LAUTENBERG. What would you describe as your basic-basic price? I would ask, also, Mr. Robbins. How much do you charge for the most basic service?

Mr. DOLAN. The most basic, which is the tier in which all of the broadcast stations are carried, and we also add to that our own News 12 service, which, as you know, is 24-hour–7-day news for each of the areas that we serve, for which we spend more than $25

million a year. The price for that tier is $13. Then you advance to expanded basic, which in our market is called "family cable," and that is $32. And that is where the price sensitivity is. That is the price that continues to increase, because embedded in it are so many services where the vendor will not permit us to carry it on a separate tier. If we are going to carry it at all, it has to be in that expanded basic. And he controls the price.

Senator LAUTENBERG. Mr. Robbins?

Mr. ROBBINS. Senator, our "broadcast basic," as it is called, which carries the must-carry signals and the local broadcast signals——

Senator LAUTENBERG. Right.

Mr. ROBBINS.—ranges in price from $10 to $14 in different places around the country.

Senator LAUTENBERG. And what is your expanded?

Mr. ROBBINS. Our expanded ranges anywhere from probably $35 to $40 around the country.

Can I make one other point, just to set the record straight here? And that is that the most recent FCC report showed that cable operators had a financial interest in less than 25 percent of the channels collectively, and that no single cable company had an ownership interest in more than 13 percent of the channels. I would also tell you that Cox's interest in programming is less than 8 percent of the channels available. I think that is a very important——

Senator LAUTENBERG. And is that thrown in the expanded basic? Where you have an 8 percent equity——

Mr. ROBBINS. I think you will find, around the country, our interest is in Discovery Communications. It is a quarter interest in Discovery Communications. And I would think that Discovery is carried on the expanded basic in virtually 100 percent of——

Senator LAUTENBERG. Do you insist that if someone wants your programming that they have to take other programming interests that you include in that package you sell them?

Mr. ROBBINS. No, sir.

Senator LAUTENBERG. So you can sell—is Discovery the channel that you talked about?

Mr. ROBBINS. Yes. But we are——

Senator LAUTENBERG. So you sell that independent of the others.

Mr. ROBBINS. Yes, but we are a financial investor in Discovery. They handle their own distribution relationships. I do not know what they are.

Senator LAUTENBERG. Yes, so they charge you back.

Mr. ROBBINS. Yes, sir.

Senator LAUTENBERG. They charge Cox back.

Mr. ROBBINS. Yes, sir.

Senator LAUTENBERG. Is that true—Mr. Dolan, what percent—do you have interest in programming companies and programs?

Mr. DOLAN. Yes, sir.

Senator LAUTENBERG. And do you get charged back? Is the process—their distribution separate from the management of your——

Mr. DOLAN. Yes. Our Rainbow Division does all of our programming.

And you asked about expanded basic. We carry 47 channels in expanded basic. Six of those belong to us.

Senator LAUTENBERG. And you pay for the service where Cablevision has an equity interest?

Mr. DOLAN. Yes, sir. Most-Favored-Nations provisions are a standard part of the contracts, and we charge ourselves what we charge others.

Senator LAUTENBERG. Yes. I wanted——

Senator BURNS (PRESIDING). Mr. Chairman—or, I mean, Mr. Lautenberg, you are out of time, and I am going to ask a question.

Senator LAUTENBERG. Well, I thought that since we were running overtime, that it was generally applied to all Members——

Senator BURNS. Lindsey, hand me that gavel. I want to ask a question.

Senator LAUTENBERG. Mr. Burns, you know, I am sure that Montana has an active interest and that you are just brimming over with the same kind of interest and curiosity that I am, so if you would indulge me just a minute more.

Senator BURNS. OK.

Senator LAUTENBERG. In the past 6 years, cable rates have tripled the rate of inflation, but the companies argue in response that cable rates have grown slower in the 3-years since the 1999 sunset of expanded-basic-rate regulation. Does this mean that the American people can expect a sustained decrease in cable rates in the coming years?

Mr. DOLAN. In my opinion, sir, if we stay with the structure that we have now, it is inevitable.

Senator LAUTENBERG. That rates will continue to come down.

Mr. DOLAN. Rates will continue to increase. As you mentioned earlier, ESPN has just raised their rates 20 percent again. We go out 7 years, and that service along, just one of the 47 that we carry in expanded basic, will cost us $14 and some cents. So you cannot possibly anticipate anything but a pattern of ever-increasing rates while you permit the vendors to dictate to the cable companies that they must be in expanded basic or you cannot have them at all.

Senator LAUTENBERG. Mr. Chairman, Mr. Temporary Chairman, just one——

Senator BURNS. You had it right the first time.

[Laughter.]

Senator LAUTENBERG. I hope not. Excuse me. That was a mutter that was intended to be heard, but I guess nobody heard.

How about advertising revenues that derive along with the programming that comes, where do those revenues go?

Mr. ROBBINS. Well, in our case, advertising revenues represent 7 or 8 percent of our total revenues. They are an offset—we look at them as an offset against the cost of programming. And in the case of ESPN, as an example, 10 percent of the cost of that channel we are able to sell advertising time against. There are claims that that number is 20, 30 percent. That is not the case, and we track it very, very carefully, Senator.

I would also like to make sure that the record shows that—it has been mentioned here earlier that we were in the sports-programming business. We are, indeed, in Louisiana, and we offer that on a tier to give our customers the choice, which is what I am asking for from the high-priced service vendors.

Senator LAUTENBERG. Mr. Hindery, the advertising revenues that are derived from YES Network, do you get to keep them, or is the policy as described by Mr. Robbins?

Mr. HINDERY. Virtually all cable programmers, Senator, share advertising revenues. We certainly do, and I do not know an exception to that rule. One of the conditions of carriage is that we give back minutes to the cable operator. Roughly 5 minutes an hour to 6 minutes an hour is sold by the cable operator for giving us access.

Senator LAUTENBERG. Thank you very much.

Mr. Chairman, thank you.

Senator BURNS. Well, Mr. Gleason wants to respond.

Mr. GLEASON. One quick response to the advertising revenues. One important note to look at for a small cable operator, like ours and most of our members, is in most cases our systems are so small that it is uneconomical to insert local ads into those cable systems, so that those programming offsets that Cox sees and whatnot on local ad sales, we do not see. In fact, we just pay the full rate, and those local ad insertions go unused because of the size we are at.

Senator BURNS. Mr. Dolan, I really liked your idea. You ought to be in farming.

[Laughter.]

Mr. DOLAN. I am sorry, sir, I should be what?

Senator BURNS. You should be in farming. Being as I feed cattle, I would sure like for everybody to buy a piece of beef before they can buy bread and milk.

[Laughter.]

Mr. DOLAN. I think every——

Senator BURNS. That has not worked for us.

Mr. DOLAN. If we can avoid the marketplace and just have everybody buy what we are selling, we are in pretty good shape.

Senator BURNS. Well, but it has not worked for us, and basically that is—and that is kind of the situation we have got here.

I want to ask, also along that line, do you think that there is a market for a packager of these things, of people to put together custom packages that could sell—you could repackage what Mr. Hindery here has to sell or any other programmer?

Mr. DOLAN. Sir, I think that is coming. We are now entering the era of what some people call "plug and play," where we will have a box on top of our television set, and it will not belong to any one of the multichannel carriers; it will belong to the home, and the home will be able to accept into that box the input of all of the multichannel providers, and the public will be in a position to buy from each of them whatever that household wants and put their menu together from the collection of vendors. And then that——

Senator BURNS. Do you think that is happening in the satellite business today?

Mr. DOLAN. I think it will be a combination of satellite and cable. They are in-common multichannel vendors, and I do not think the public really cares whether the programming reaches them through the sky or through a wire; they just want it to reach them, and they want to be able to accept the parts of it that they prefer and

reject what they do not want, and they will have their own budget and their own ideas about that.

Senator BURNS. Mr. Hindery, on your call for parity, are you saying that you should have open access to that cable system regardless of its capacity?

Mr. HINDERY. Oh, I do not say that at all, Senator. I think the prerogative of the cable operator to make editorial decisions as to what he or she carries is absolute. I do not question it, nor do I dispute it.

Parity, for me, Senator, is a simple concept. It simply says that cable operators' programming or the cable industry's programming can be treated no more favorably than mine. It is a discrimination concept. I do not dispute the prerogative of any First Amendment carrier to make programming decisions.

What I find concerning, and so deeply concerning, Senator, is when an independent programmer is left off the dial or put deep on the dial or put in a package that is just blatantly unfair, while the cable operator's vested interests are served. And that is coming into play in the Internet space, as well as in the video space. It is wrong. It is what Gerald Ford, President Ford, said in 1974, needed to be addressed when we got to this stage, and I think the time is here, Senator.

Senator BURNS. Well, 30 years makes a hell of a lot of difference, I will tell you that. As I understand it, though, DirecTV chose to carry YES Network on its satellite service, but Dish Network chose not to do so. Did Dish Network also unfairly discriminate against YES? Or was it simply a case of a multichannel video provider deciding that it was too expensive or that it did not want the product at all?

Mr. HINDERY. At the time that we first came into the market, Senator, you may recall, Dish and Direct had already announced their intended merger. They have different packaging and different programming mixes. We opted and stuck with Direct. We were forestalled from Dish for that year. It was a decision made by the Dish folks.

At the time the merger broke up here a few months ago, we offered EchoStar/Dish the exact same deal, Senator, that DirecTV has. It is their prerogative to take it or not. There is no discrimination whatsoever. I, for one, have never come here—I do not believe in cable exclusivity, even when I had the privilege of running a cable company. And I think the greatest opportunity for consumers, to Senator Wyden's comment, who is no longer here, is when programmers have opportunities to go on satellite and cable.

Senator BURNS. And then I am going to ask one more question here. Mr. Robbins, I am also concerned, as Mr. Stevens is, about Universal Service, but we are going to bring the industry and the FCC and the Joint Board together and we are going to make some decisions. Now, some decisions are going to have to be made on Universal Service, and that is going to cause a little bit of concern in the industry how we attack that.

I want to also ask Mr. Kimmelman and also even on your definition of "parity." And you used in there a term, "market value." Who sets that market value?

Mr. HINDERY. I think that it is certainly not the Committee. I think it is—I think you can codify it, Senator, in a way that when a dispute arises, like in any antitrust or discrimination claim, the burden falls on the parties to prove that they, in fact, have been discriminated against. But it is not impractical to embed a concept of fair market value of programming. Many of the abuses that Mr. Gleason speaks to would be obviated by that. It is a very simple concept that it is embedded in this concept of parity. Regardless of who owns you, regardless of what your content is, so long as you get the fair market value of your programming, everything will calm down here and fairness will come back into the world for consumers.

It is not impractical either at the FCC or at this Committee level, Senator, to talk about concepts of fair market-value programming. The burden, then, would fall on me to prove that I was not getting that, that I was being discriminated against. But it would give me an avenue, it would give the independent programmer an avenue, finally, to stop the sort of hypocrisy and vertical integration abuse that we promised you was not going to come in here.

Senator BURNS. Since I am in the auction business, let us just sell it all at auction. How is that?

Mr. HINDERY. It works pretty well in Montana, Senator, and has for a long, long time.

Senator BURNS. It works for a lot of products. Would you be willing to put your product on the auction block?

Mr. HINDERY. If his cow sits next to my cow, you got it, sir.

[Laughter.]

Senator BURNS. Well, I mean, I would look at it that way, but——

Mr. HINDERY. I am——

Senator BURNS.—that is basically what you are saying.

Mr. HINDERY. I am in the cattle business, like you are, and it is one thing I kept from my old TCI days. And I will tell you, Senator, the fair market value of his programming and our programming, Discovery versus YES, go for it.

Senator BURNS. Well, that is what I think. You know, I have always looked at that about the same way. You know how to make a small fortune feeding cattle, do you not?

Mr. HINDERY. Oh, I do, sir.

Senator BURNS. Start with a big one.

Senator Sununu?

Oh, Senator Nelson, I am sorry.

Senator NELSON. Well, to keep with the agricultural analogy——

[Laughter.]

Senator NELSON.—Mr. Chairman, it seems like we are arguing about whose cows are going to get fed the most here.

Senator BURNS. Or gored.

Senator NELSON. Whichever way you would like to put it.

By the way, Mr. Chairman, why did FOX not appear? And why did ESPN not appear? I heard——

Senator BURNS. I cannot answer that. It was the Chairman of the Committee that formed the witness list and brought everybody together, and I was not privy to that information. I am sorry.

Senator NELSON. All right, Mr. Kimmelman, you have got to make sense out of all this for us. If we are up here trying to do right by the consumer, and we have got the competing demands here—on the one hand, we have higher programming costs, particularly sports programming; on the other hand, we have got a $70 billion investment to upgrade the cable network, which has to be passed on—where is the truth in all this?

Mr. KIMMELMAN. Well, Senator Nelson, if you look at the chart I put into my testimony, it shows you the track record of cable deregulation since 1984, the brief period when Congress stepped in and re-regulated cable in 1992 to 1996, and then since then. You will see on that chart the only time that cable rates dip and stay flat is during regulation. You will see that, if you look at what the FCC data show and the GAO data show so far, that where you have two cable companies competing head to head offering infrastructure investment and approximately the same channels, prices are, on average, 17 percent lower than where there is only one cable company but still two satellite companies.

I would suggest, Senator Nelson, that there is a lot of matching up of costs that needs to be looked at with revenue streams that need to be looked at. And in reality, as we have suggested to this Committee before, we believe deregulation went too far too fast. Now, I do not see anyone interested in putting that genie back in the bottle, anymore than a number of others, so I believe that, going forward, it makes the most sense to look at the idea of some kind of a parity of unbundling in a way that is fair to both cable operators and fair to programmers, that eliminates discriminatory practices. Senator Burns is absolutely right. Fair market value is very, very hard to determine in this area.

In the past, antitrust officials have established indices, including for programming prices, just to monitor over time. Now, that suggests that what was charged before was fair, which may or may not be the case. But it is a very imperfect art.

But, unfortunately, the flip side is, unrestrained market activity in this realm has drastically driven up prices for consumers, has opened the door to various leveraging mechanisms for programmers who have very, very popular content, and the consumer is squeezed. We need something better than that.

Senator NELSON. Mr. Hindery, your costs have been going up quite a bit, primarily because of what you have to pay ballplayers?

Mr. HINDERY. Yes, Senator. Right.

Senator NELSON. I want to point out to you—I know you do not directly affect this, but in that industry there is a gross inequity. I am going to take this opportunity to get it out on the table, as I do wherever I can. With the costs that are paid to ballplayers and with their pensions, there is one group that has been cut out by Major League Baseball, and that is the old Negro League players. And I have been, because a lot of them are retired and living in Florida and now getting quite old without a pension, pushing this issue very hard. And there is a new COO of Major League Baseball, who has picked up the mantle, but he is getting swatted down by other people. And I would appreciate you getting into this issue on equity of giving those Negro League players, who were not allowed to play Major League Baseball. Even though, presumably,

Major League Baseball was integrated, when Jackie Robinson played in 1947, it was not. And it was not fully integrated until the last team integrated in 1959, well over a decade later. And it is those Negro League players who continued to play who have no pension.

Mr. HINDERY. Senator, the deliciousness of Major League Baseball is found in its players of color. More than half of our players today are men of color. Nobody has been more sensitive to this issue than you. It is a compliment that it is a small issue in a national context. It is a wonderfully fair issue, otherwise. And my hope, and I know a lot of the people who have brought broadcast dollars to the industry, is that the veterans, those men who really did not receive the benefits of what we see today, and you have my word, Senator, that, on a personal level, I will get involved.

Senator NELSON. Thank you very much.

Mr. HINDERY. You have been wonderful on that issue.

Senator NELSON. Thank you, Mr. Chairman.

Senator BURNS. Oh, Senator Sununu. Sorry about that. I am taking a little nap here.

STATEMENT OF HON. JOHN E. SUNUNU, U.S. SENATOR FROM NEW HAMPSHIRE

Senator SUNUNU. That is quite all right, Mr. Chairman. Thank you.

It seems to me we are dealing with some pretty important concepts here having to do with the cable television industry, principally the rates, making sure that we do not have government regulation or unfair competitive practices that affect rates and access adversely, and maybe we can sum up both of those issues or questions with what was referenced before by one of the panelists, or maybe many of you, fairness. We want to make sure this is a fair system. And this is something that touches just about every American's life at some level—entertainment and television, it is something that is pretty pervasive in American culture.

But I think it is important that we not get too carried away, that we retain our perspective. Because as I listen to the questions and the answers here, to a certain degree what I hear relatively wealthy firms and individuals arguing about are things like where to place The Weather Channel and the challenge of protecting the consumers' right or ability to access three or four channels of 24-hours-a-day sports coverage.

And in one of the testimonies that was presented, there was lamentation that we have seen a reduction in the number of independent TV production studios since the early 1990s, as if the 1980s were a golden age of prime-time television content. So I think we need to maintain a little bit of perspective.

But these are issues that do touch the public, and we are concerned about the fairness. But times have really changed an enormous amount over the last 20 years, and I think some of the testimony or suggestion that, the future of technology or the country or the rights of individuals are being quashed here by competitive forces or vertical integration or potential acquisitions—I think there is a little bit of hyperbole there, and I just want to make sure we keep that perspective.

I do want to begin with the issue of fairness in a very specific case. Mr. Hindery mentioned discrimination. You are concerned about the discrimination of the cable providers. So I want to ask Mr. Dolan, in your dispute with YES Networks, were you discriminating, were you attempting to treat their product or content differently than you would treat content or a channel owned by your company?

Mr. DOLAN. No, sir. I think that whole idea diverts us from the real subject. We have pointed out that on expanded basic, which has been the issue here, we have 47——

Senator SUNUNU. Yes, I will get to expanded basic, but there was at least a suggestion—we know there is a dispute here; it is no big secret—but there was a suggestion that discrimination was the issue. And you say no, you were not treating their product any differently than you were treating channels or products of your own. Mr. Hindery, do you disagree? If it was not the issue there.

Mr. DOLAN. If we were discriminating, we were discriminating against a vendor who wanted to have an outrageous increase in the price for his product from one year to the next.

Senator SUNUNU. But were you offering or requiring to treat the product differently than you would treat your own——

Mr. DOLAN. No, sir. We said to that network——

Senator SUNUNU.—product?

Mr. DOLAN.—"If you want to come in with that kind of price, we will carry you. We will offer you to all of our subscribers and let the subscriber decide whether or not they want to pay that price."

Senator SUNUNU. And I understand, there was an agreement struck and it is effectively a tiered structure, and——

Mr. DOLAN. And we——

Senator SUNUNU.—terrific. I am in favor of you reaching an agreement. That is not the issue. Was there an attempt to discriminate, to treat YES differently than they were treating one of their own——

Mr. HINDERY. Absolutely, Senator. That was the—that much-reported settlement between our two companies, the principal term of the settlement was the contractual commitment by Cablevision, from the first of April forward, the three services would be treated with complete parity. If Mr. Dolan says that there was no discrimination going on, this thing would have been settled a long time ago. But the Attorney General of the State of New York embedded in a contract the concept of parity upon evidence that, in fact, the offer made to us was not being made to his own services. It was—the fundamental principle of the settlement was contractual parity, and we got it. And it is disingenuous, with all respect, Senator, to suggest otherwise. I mean, there are countless articles and testimony to the contrary.

Senator SUNUNU. Mr. Hindery, you suggested that 90 percent of homes were controlled by seven companies. Where did you get that number, and what does that mean?

Mr. HINDERY. Seven——

Senator SUNUNU. And who controls my home?

Mr. HINDERY. I do not know which home you are talking about, Senator, the one here or the one in New Hampshire.

Senator SUNUNU. New Hampshire.

Mr. HINDERY. I do not know precisely, Senator. Seven cable companies have access to 90 percent of Nation's homes without competition, wireline competition, for video services to those homes.

Senator SUNUNU. So you are talking about the cable providers.

Mr. HINDERY. Seven cable companies have control—in a unique fashion, wireline video service to 90 percent of the Nation's homes, beginning with Comcast as the largest, post its acquisition of AT&T Broadband, including two of the gentlemen to my left.

Senator SUNUNU. You are not suggesting—it sounded as if you were suggesting that they control 90 percent of the content that comes through the pipe.

Mr. HINDERY. Yes, I did not—the statement, I think, is quite clear, Senator; it is access.

Senator SUNUNU. How many channels do I get for my $13 on basic, Mr. Dolan, Mr. Robbins?

Mr. ROBBINS. Senator, it varies by system anywhere from 8 to 12, I would suspect.

Mr. DOLAN. Well, in the New York area, we have 15 broadcast stations, so they are all included. There are various public-service channels that are added to that. And then, as I mentioned before, we also include our News 12 24/7 service.

Senator SUNUNU. Great. So your concern about retransmission consent, it really manifests itself in defining what is in the expanded basic, correct?

Mr. DOLAN. Well, yes, it does, because the broadcasters have the right—one, they have the right to require us to carry——

Senator SUNUNU. How many of the channels in your expanded-basic offering are there by virtue of the existence of the retransmission-consent requirements?

Mr. DOLAN. Well, that is an interesting question. I mentioned before that there are 47 channels in our expanded basic, and we own 6. Thirty-three of the balance are owned by media companies, mostly broadcasters.

Senator SUNUNU. But how many are there—media companies exercising their powers through the retransmission-consent regulations?

Mr. DOLAN. A substantial number of them. I am not saying that the channels that they own are without merit. Many of them are very important channels, and that is part of the problem. But they are put in a position where they say to us, "You cannot have the broadcast network that we represent unless you carry our cable service, and not only carry it, but you must carry it in expanded basic, and you must pay whatever we ask."

Senator SUNUNU. Mr. Kimmelman, you talked about getting rid of the retransmission-consent requirements or altering them where FOX is concerned, is that right?

Mr. KIMMELMAN. Yes.

Senator SUNUNU. And what is the rationale behind that?

Mr. KIMMELMAN. Very simply this. In 1992, when Congress passed the Cable Act with must-carry and retransmission consent, the primary rationale for government intervention to require carriage of broadcast signals in a basic-cable tier was that cable had become the predominant mechanism for distribution of multichannel video—it was the predominant mechanism of getting your

local stations, AB switches did not work, people's rabbit ears were not convenient—and that broadcasters had no other mechanism to reach the consumer. I am suggesting that——

Senator SUNUNU. So why discriminate against FOX? Why not just get rid of it altogether?

Mr. KIMMELMAN. Well, I think retransmission consent is appropriate to revisit. I am suggesting in the context of the News Corp deal where they purchased DirecTV and had nationwide distribution capabilities, that it is a unique opportunity for them that they would not have had in 1992——

Senator SUNUNU. So your concerns about the use of retransmission consent carries even further than the acquisition.

Mr. KIMMELMAN. Yes, sir.

Senator SUNUNU. I know we all like to pick on the big guy. We all envision ourselves as the David to some Goliath out there. And, as policymakers, I want to make sure that we are not just setting up discriminatory rules on the basis of who your main competitor happens to be today and that in the long run those rules create a good environment.

Mr. Gleason?

Mr. GLEASON. If I could just respond real quickly to the News Corp/DirecTV acquisition and the retransmission-consent issue. Really to break it down, particularly in a smaller-operator, more rural-operator environment, as Senator Burns and you know, from New Hampshire, as well, I mean, largely what our customers rely on is local broadcast stations for much of their hometown content, so to speak. If the FOX affiliate in our markets—and we also have to recognize that DBS's largest concentration of subscribers is in rural areas—if News Corp is able to take FOX and say all of a sudden for their broadcast O&Os that they have and they say, "You know what? Now to get FOX it is going to cost you 5 bucks a sub," and DirecTV is happy to pay it in their area, it goes from one pocket to the other, and the first thing you know is the rural operators——

Senator SUNUNU. Would you be able to serve your customers better if all of the requirements under retransmission consent were eliminated?

Mr. GLEASON. I think so.

Senator SUNUNU. You think so.

Mr. GLEASON. I mean, I—yes, I would think so because of—what has happened with retransmission consent I do not think is what was ever intended. What was intended is exactly what Mr. Kimmelman said, is to give broadcasters a way to make sure they had adequate distribution as competing with cable. I do not think anybody intended for retransmission——

Senator SUNUNU. You do not think greedy local cable providers would, sort of, misuse their power of decision to prevent local——

Mr. GLEASON. Well, I would argue——

Senator SUNUNU.—communities from seeing important pieces of programming that——

Mr. GLEASON. Well, no. I mean, local broadcast content has always been important, particularly for rural operators, and I do not know of any rural operators that have told broadcasters that, "We do not want to carry your product." I think what happened was,

as the unintended consequence, is now we have reruns of soaps on the air because of retransmission consent, and I did not have any customers calling my office telling me, "I wanted to see a soap opera again."

Senator SUNUNU. I am not going to comment on that.

[Laughter.]

Senator SUNUNU. I do not want to alienate very important segments of the electorate——

[Laughter.]

Senator SUNUNU.—by criticizing anyone's viewing habits.

I think that is it. Thank you, Mr. Chairman.

Thank you to the panelists.

Senator BURNS. I thank Senator Sununu. You always ask good questions.

I do not have any other questions. I have a comment, however.

And, Mr. Gleason, I want to clear the record. It was not my suggestion that government should mandate that the basic tier of stations should include The Weather Channel.

[Laughter.]

Senator BURNS. Although it is a good idea, but I do not want to make it mandatory. And I do not want to make it mandatory that you have to carry MTV, either. I mean, there is something we could do without pretty quick, as far as I am concerned, if I was on the purchasing end. I think I have made that statement before. I am pretty outspoken about that.

But I want to thank the panel today. I want to thank you for your frankness and your openness. And this is not the last that we will hear of this subject. We know that. As long as we have Mr. Kimmelman around——

[Laughter.]

Senator BURNS.—this will continue to be a raging debate, and he will always bring good, sound logic to the table, of which he has some distrust of the market. But, nonetheless, we appreciate his input, and all of you, today.

And I am going to leave the record open. There may be questions by other Senators who could not attend today, and if they ask questions, we would ask you to respond both to them and the balance of the Committee.

We thank you today, and we will call these hearings to a close.

[Whereupon, at 12:15 p.m., the hearing was adjourned.]

APPENDIX

Prepared Statement of Hon. Ernest F. Hollings,
U.S. Senator from South Carolina

Thank you, Mr. Chairman. I appreciate your leadership in scheduling this hearing to focus on the effects of consolidation in the video marketplace, and more particularly, on the vexing problem of rising cable rates.

Between 1996 and 2002 cable rates have increased 45 percent—nearly triple the 17 percent rate of inflation over the same period. While only part of these increases have come since rate deregulation in 1999, the fact remains that today's consumer is shouldering significant price increases each year in order to obtain video programming services. According to FCC's 2001 annual report on cable industry prices, cable prices rose by 7.5 percent, while inflation crept up by just over 3 percent. While data for 2002 has not yet been released by the FCC, I fully expect that it will only confirm what consumers already know—that cable price increases continue to outstrip the growth of the average consumer's paycheck.

Faced with such criticism, the cable industry has pointed to the cost of sports programming as one of the main culprits driving higher monthly rates. Over the past decade professional sports costs have skyrocketed to dizzying heights. In 1996, the payroll for the entire New York Yankees was $52 million. Today, it is over $152 million. Not surprisingly, as the cost of professional sports has increased, owners have looked to television—and increasingly to cable—for greater revenues to cover costs. According to one analyst, the totals paid by broadcast and cable networks to air college and professional sports events has increased from $2.8 billion in the 1997–98 season to $4.9 billion in the 2001–02 season.

While these cost increases are indeed alarming, we should not assume that controlling the cost of sports programming will necessarily result in lower consumer cable rates. Indeed, despite significant inroads made by satellite providers over the last several years, cable operators continue to enjoy significant market power in many areas of the country. As a result, given the cable industry's desire to seek a return on their network investments—now nearing some $70 billion, it is important that Congress continue to carefully monitor developments in an increasingly concentrated video marketplace. For example, if operators are able to negotiate lower programming costs, those savings should be passed through to consumers in the form of lower prices and better services.

Mr. Chairman, over the past several years, we have seen significant consolidation in the cable and satellite industries. At each turn, we have been met by promises that consumers would reap significant benefits from such mergers, and that the "efficiencies" and "synergies" of such combinations would benefit consumers and keep prices in check. With the recent announcement of yet another media merger—this time between News Corp. and DirecTV—our regulators must carefully consider whether today's public promises will actually result in future benefits to video subscribers.

As such, Mr. Chairman, I welcome today's hearing to examine in detail some of the fundamental reasons driving recent subscriber rate hikes and to explore ways of bringing the consumer's face back into the picture.

I look forward to the testimony of the witnesses and to their responses to our questions.

Prepared Statement of Hon. Daniel K. Inouye, U.S. Senator from Hawaii

I want to commend Chairman McCain for holding today's hearing on media ownership. It is particularly timely given the FCC's announcement that it will complete its review of six major rules affecting the media market on June 2. The *New York Times* has described the impending decision as possibly the most significant change governing media ownership in a generation. Unfortunately, the outcome could be an epitaph for the free press as we know it.

If the FCC, as expected, jettisons the remaining rules limiting media companies from owning more larger numbers and combinations of television stations, radio stations and newspapers, we may soon face a media landscape where a few large conglomerates control the news and entertainment programming available to all Americans—whether they live in Hawaii, Alaska, South Carolina or Maine. While today's hearing will focus mainly on the national television ownership cap and the newspaper/broadcast cross-ownership rule, we should not lose sight that other rules are under review and that the cumulative impact will likely have many unforeseen consequences. We are fortunate to have before us today industry representatives who can help us comprehend the far-reaching implications of this decision.

We should also reflect on the effect that deregulation has had in other media markets. Since the national radio cap was lifted in 1996, the commitment to community based, local news has declined. Local artists have lost their ability to get air time and programming has become nationalized and homogenized. Similar effects are also evident in the television market, which has been marked by significant consolidation over the last few years. In addition, since the financial interest and syndication (Fin Syn) rules were lifted, independent programmers have been nearly shut out of the primetime schedule. In 1992, sixteen new television series were produced independently. In 2002, there was only one independently produced series selected by the networks. Despite these cautionary tales, additional deregulation could enable a single entity to own nearly every editorial voice in a local community, including two television stations, multiple radio stations, the local newspaper and a cable system. In Hawaii, such an outcome could mean that the entire state essentially has one source of news and entertainment.

Press reports also have signaled the FCC's intention to raise the national television ownership cap from 35 percent to 45 percent. While raising the cap to 45 percent may sound like an incremental change, the significance is much greater given that the current rule discounts a company's actual ownership reach by 50 percent for all of its UHF stations. As a result, raising the cap to 45 percent could allow networks and other large owners to reach up to 90 percent of the country. The failure of the FCC to review the UHF discount is inconsistent with its mandate to determine whether all of its media rules "are necessary in the public interest as a result of competition." In addition, relaxation of the cap would undermine our unique system of broadcasting, with its combination of national networks and local, independently-owned and operated broadcast outlets. Retaining the 35 percent cap would ensure that a proper balance of power is maintained between the national networks and their local affiliates, which in turn protects the public interest.

I have joined many of my colleagues in asking the FCC to delay its decision to ensure that there is an opportunity for meaningful review and comment on any proposal to change these rules. In addition, I am troubled by recent reports of a quid pro quo arrangement where a company agrees to compromise on the national television ownership cap in order to receive favorable treatment on the newspaper/broadcast cross-ownership issue. It is imperative that rigorous analytical examination, and not behind-the-scenes deals, determine the outcome on these critical issues.

A robust and antagonistic debate is a critical component of our democracy. While competition among five or six large companies might be enough to protect consumers in a market for widgets, I believe caution and prudence to be the better course for the marketplace of ideas.

I want to thank the Chairman again for holding this important hearing. We look forward to hearing the testimony of our distinguished witnesses.

ESPN
NewYork, NY, May 27, 2003

Hon. JOHN MCCAIN,
Chairman,
Committee on Commerce, Science, and Transportation,
Washington, DC.

RE: VIDEO COMPETITION

Dear Mr. Chairman:

Thank you for allowing us this opportunity to add to the record of the Senate Commerce Committee hearing of May 6, 2003 on competition in video programming and more particularly issues related to cable television. Our position on the matters addressed by your Committee in this hearing is very clear: there is no need for government intervention in this area. Today, cable and satellite customers do in fact have choices among competing service providers and do have access to various pack-

ages of services. Consumer interests are well served regardless of the provider, For about $40 a month for the most popular service offerings, cable and satellite TV provides the greatest value in today's entertainment marketplace. And, we are proud to say that ESPN is a major contributor to this success.

ESPN was prominently mentioned in your hearing and we therefore would like to take this opportunity to focus on a few key points related to our business and our relationship with our distributors that we believe will be useful during the Committee's future deliberations on these issues.

Placing Blame on ESPN and Other Cable Programmers for Rising Cable Rates Is Wrong.

Like all cable programmers, ESPN obtains distribution through arm's length negotiations in which our rate provisions are clearly stated. Those negotiations reflect a very substantial exchange of value and inherently acknowledge the direct and indirect revenue cable operators derive from their association with ESPN. ESPN is the industry leader in acquiring new customers, maintaining customer satisfaction, and in driving local advertising sales revenue for operators. Taking all of that into account, ESPN*s average net cost in 2003 is just above $1 per sub per month and while our cost to our distributors has been growing, our license fee growth is clearly not the predominant cause of retail rate increases as alleged by your cable operator witnesses.

By focusing only on the cost side and ignoring revenue directly and indirectly associated with ESPN services, operators are trying to use programmers in general and ESPN in particular as scapegoats to justify retail price increases in order to preserve their operating margins which typically run a very substantial 30 to 40%. Cable operator programming costs in total represent only about 30 to 35% of their overall costs, an amount well below the percentage paid by other content driven businesses for entertainment product. On average, operators pay only about $11 per sub per month to acquire all their expanded basic programming and they recoup over $4 per sub each month in local advertising sales. In addition, launch and marketing support payments to operators further reduce the cost of programming putting even less pressure on the amount that is covered by consumers in their monthly cable bills.

Indeed, reports generated by the cable industry on their own financial results confirm that costs associated with infrastructure development and debt management are very significant. In many cases these costs exceed expenditures for programming. At a cost of over $75 billion, the cable industry has added to the types of services it provides its customers (e.g., broadband, video on demand, cable modem internet access, high-definition television) and ESPN has been at the forefront of providing programming, services and marketing support for all of them. It is completely disingenuous, however, for operators to argue that their fastest growing, new revenue categories should be excluded from any analysis of the underlying economics of their business by focusing solely on the cost of programming in relation to retail rates. If it were not for the core video business that existed before this new investment in infrastructure upgrades, none of these new business opportunities would be available. They run over the same plant, they utilize the same infrastructure and they are natural and logical extensions of a mature, multichannel video business. And just like programming services, not every customer will want or use these services; despite the impact their development has on retail rates.

The blame placed on programmers by operators is simply an attempt to gain leverage over entities that cable operators do not own. Despite having very healthy businesses with a growing customer base and an array of new service offerings, operators are asking Congress to improve their already healthy operating margins with no corresponding indication that consumers would at all benefit from any legislative or regulatory action.

A-la-carte Is Not Pro Consumer

The most widely suggested "solution" to the rising cable rates issue is to require mandatory a-la-carte distribution of sports programming services like ESPN. But even the cable industry's own trade association, the National Cable & Telecommunications Association, has acknowledged in a ″white paper″ dated May 2003, that ″mandatory unbundling is not a viable option,″ Mandatory a-la-carte distribution of popular program services introduces very substantial new costs and will take away significant national and local revenue. Subscribers who don't have set top boxes (more than half of the cable universe today) would be forced to pay an additional monthly fee (estimated to be $3.25 per box) to receive ESPN and other popular services. Distribution of these services would drop significantly and the corresponding loss of advertising sales revenue would be substantial. Large, popular program serv-

ices like ESPN and small niche programmers would all suffer. Indeed, many niche services would be unable to survive in such an environment. Ultimately, all consumers would have higher monthly bills and the wide array of programming choice offered by cable would diminish. In short, consumers would pay more and get less.

If in fact a-la-carte distribution of program services was a viable business model, it would have been embraced by cable's primary competitor, the DBS industry, and indeed by operators themselves. Neither has done so, The satellite distribution business has realized substantial growth over the past several years by offering customers significantly larger bundles of program services at competitive prices to cable. By any measure, that has proven to be a successful strategy and has driven their market share from zero to approximately 20% in very short order. Cable operators themselves own a substantial number of programming services, including services with interests in national and regional sports. On the whole, operators have not offered a-la-carte distribution of their own products. Indeed, other than in the New York metropolitan area, to the best of our knowledge regional sports networks, including those owned by major cable operators, are almost universally distributed on the expanded basic tier of service. In his testimony before your Committee, Mr. Robbins made a particular point of noting that his company, Cox, owns two regional sports networks. One of those is located in Louisiana and Mr. Robbins told the Committee that this service (which has a wholesale cost above $1 per sub per month) is offered "on a tier" to give his customers "choice." It is our understanding, based on our review of channel lineups in the Cox Louisiana systems and given reports we get as a seller of programming to that Cox network, that as of the day of your hearing, the "tier" to which Mr. Robbins referred is the same expanded basic service level on which ESPN is distributed in those systems. In Cox's San Diego system, the Cox sports network is also, to the best of our knowledge, offered only on expanded basic.

All this points to what is really going on with respect to the operator's position before your Committee. It is an attempt to get the government to take steps to hinder the business inspects of ESPN and gain leverage over all non-affiliated programmers. They are looking to improve their margins and gain a government-established competitive advantage for their own local and national sports services that compete with ESPN. It's that simple.

We truly do not believe that operators want Congress to regulate their business. Cable television is an outstanding product at a terrific price. Compared to almost any other form of entertainment in America, the $40 the average consumer spends for expanded basic service and 24-hour a day access to dozens and dozens of general entertainment, news, sports, weather, movies and specialty programming services is a bargain. The ESPN services make a substantial contribution to this business and through new and innovative products and programming to its growth. We will continue to do so and we believe the competitive market and not government regulation is the best way to ensure that consumers continue to be well served.

Thank you.

Sincerely,

GEORGE BODENHEIMER,
President.