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HEARING

BEFORE THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

JANUARY 31, 2006

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SENATE COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

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VIDEO CONTENT

TUESDAY, JANUARY 31, 2006

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

The Committee met, pursuant to notice, at 2:30 p.m. in room SD–562, Dirksen Senate Office Building, Hon. Ted Stevens, Chairman of the Committee, presiding.

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

The CHAIRMAN. Good afternoon. This is a strange day around this place, State of the Union day. I'm sorry to proceed with the hearing, but we feel it's necessary to keep going, get these hearings that we have scheduled through so we can start the markup process on the bills that are before us.

We do appreciate your all being willing to come and join us today in this hearing. My colleagues are involved—have sent word to me that they're involved in some meetings. They should be along in a few minutes. I want to start and just make a few comments myself and then we'll see how many people can be here by the time we start listening to your presentations.

Retransmission consent allows broadcasters to negotiate compensation for their popular over-the-air content. And the big-four broadcasters—ABC, NBC, CBS, and FOX—have used retransmission consent to negotiate carriage for both their over-the-air programming and programming of cable channels in which they have invested.

Some small cable companies have contended that the broadcasters use retransmission consent to go further than Congress intended. And some of the small cable companies want to offer family tiers, but the contracts the programmers offer would require them to air content not appropriate for children and for the majority of their viewers. Other rural providers have told us the price they are asked to pay programmers for the content is substantially higher than their urban counterparts. And we have been asked to hear from an independent programmer who states that his ability to get carried on cable is affected by this concept.

We want to give cable and satellite providers a chance to respond and detail how they carry out this retransmission concept.

Some satellite carriers have argued that the so-called "terrestrial loophole" allows larger cable companies to lock up exclusive rights to sports programs, and we want to listen to comments about whether or not these lead to anti-competitive rates for those programs.

I'm told that exclusive contracts are not allowed for any sports delivered by satellite, but that rule does not apply to content delivered by cable. And I expect we'll hear from both sides of that issue today.

And we're well aware of the FCC's consideration of the Adelphia merger. It's not our goal to focus on that transaction here today, but, of course, you're free to comment, if you wish.

We postponed the hearing for video franchises this morning, and I am sorry that we had—felt compelled to do that. But the hearing will be rescheduled for February 15th at 10 a.m. We've invited the FCC to appear that day, but we have not yet received the nomination for the fifth commissioner, so we decided to reschedule that hearing and take up the one we postponed for this morning. I apologize for that inconvenience to those people affected by this change.

We really are trying, as I said, to proceed as rapidly as we can with the Committee's agenda of hearings that have been requested in order that we can get to the legislation which is pending before us to update our communications laws.

Now, there is no one I can ask if they want to make an opening statement, so we will proceed to the list of our witnesses before us.

We do have a letter here from NTCA to me and Senator Inouye which I have been asked to put in the record, and we'll do so, because of the statement that it represents over 560 rural-community-based telecommunications providers. It will be printed in the record.

The CHAIRMAN. Now, I believe we'll just proceed in the line that's just from left to right. We'd be happy to hear from you first, Mr. Ben Pyne, the president of Disney and ESPN Networks Affiliate Sales. And happy to have your statement. Thank you very much.

STATEMENT OF BEN PYNE, PRESIDENT, DISNEY AND ESPN NETWORKS AFFILIATE SALES AND MARKETING

Mr. PYNE. Mr. Chairman, thank you very much. My name is Ben Pyne, and I am the President of Disney and ESPN Networks Affiliate Sales and Marketing. In that capacity, I supervise negotiations for the distribution of all of the Disney and ESPN cable and satellite services, as well as retransmission consent negotiations for the ABC-owned television stations.

This afternoon, I would like to make three simple and direct points:

First, there was widespread and authoritative agreement that a la carte distribution of cable and satellite programming networks would increase costs and drain revenues within the distribution system, with the result that consumers would pay more and get less.

Second, our company offers our ABC-station programming, Disney Channel, and ESPN individually to cable and satellite operators. And we do not require operators to take any other services to get ABC, Disney Channel, or ESPN. And, again—this is a very important point—our company offers our ABC-station programming, Disney Channel, and ESPN on a stand-alone basis to cable and satellite operators, and we do not require operators to take any other services to get ABC, Disney Channel, or ESPN.

Third, retransmission consent represents the fundamental American business principle that if another business wants to sell content that we have created and assembled, they need to first get our permission and then compensate us appropriately. Our retransmission consent negotiations reflect our interest in a fair exchange of value for either cash or carriage of our other services or products in ways tailored to expand our distributors' service to their customers and otherwise meet their needs.

Our opponents would have you believe the broadcast networks dominate and abuse the retransmission consent process nationwide, but this simply is not true. ABC owns only ten television stations. The other 215 stations that comprise the ABC television network are owned by other broadcasting companies. As a result, our company is only involved in retransmission consent negotiations with cable and satellite operators in ten markets across the country. We are not even in the room for the retransmission consent negotiations in the other 215 markets.

In the ten markets where we do negotiate retransmission consent, we strive to strike a fair bargain. ABC invests more than $3 billion annually to create or acquire programming. It is plainly unreasonable for any distributor to expect to take that product and sell it to consumers without compensating us. And we offer tremendous flexibility in the kinds of compensation that we are willing to accept.

First, in the ten markets where we are part of the negotiation, we always offer a cash stand-alone option for carriage of just our ABC station. Attached to my testimony is an economic study that would support a cash price as high as $2 per month, yet we charge less than $1 per month. We have made it our policy to work particularly hard to accommodate the needs of smaller cable operators. Although we had no legal obligation to do so, we have negotiated agreements for all of the Disney, ABC, and ESPN services with the National Cable Television Cooperative. These co-op deals give small operators the buying power of an 8-million-subscriber multiservice operator.

We also work hard to accommodate the small operators on retransmission consent. We have just completed negotiations with more than 60 small cable operators. Some elected to pay cash and have no obligation to carry any of our other services as part of that process. The majority of these small operators declined to pay cash, however, and we were extremely flexible in crafting deals to meet their needs.

Our success in completing all of these negotiations belies the assertion that there is a widespread problem requiring government intervention in this process.

Thank you very much.

[The prepared statement of Mr. Pyne follows:]

PREPARED STATEMENT OF BEN PYNE, PRESIDENT, DISNEY AND ESPN NETWORKS AFFILIATE SALES AND MARKETING

Thank you Mr. Chairman, Mr. Co-Chairman and Members of the Committee. My name is Ben Pyne and I am the President of Disney and ESPN Networks Affiliate

Sales and Marketing. In that capacity, I supervise negotiations for the distribution of all of the Disney and ESPN cable and satellite services as well as retransmission consent negotiations for the ABC television stations.

This afternoon I would like to make three simple and direct points:

1. There is widespread and authoritative agreement that a la carte distribution of cable and satellite programming networks would increase costs and drain revenues within the distribution system with the result that consumers would pay more and get less.

2. Our company offers our ABC station programming, Disney Channel and ESPN individually to cable and satellite operators and we do not require operators to take any other services to get ABC, Disney Channel or the ESPN network.

3. Finally, retransmission consent represents the fundamentally American business principle that if another business wants to commercially exploit content that we have created and assembled, they need to first get our permission. Our retransmission consent negotiations reflect our interest in a fair exchange of value for either cash or carriage of other of our services in ways tailored to expand our distributor's service to their customers and otherwise meet their needs.

Let's start with a la carte. Some would have you believe that a la carte is a panacea for every perceived ill from cable rates to indecency. In fact, it is not. The expanded basic bundle has emerged as the most prevalent form of subscription television offering because it provides great value to the consumer and is the most economically efficient way to deliver the product. A la carte would both increase costs and drain revenues from the system so that even consumers who selected only a few channels would pay more than they pay today for expanded basic. Costs would rise because of the need to provide expensive addressable set-top boxes on every consumer television set and because individual networks would need to dramatically increase promotional expenditures. Revenues would be drained because advertisers on both the national and local level would flee from channels with significantly reduced distribution. The record in the a la carte proceeding at the Federal Communications Commission contains letters from leading advertising agencies confirming the likely drop in advertising revenue. Of course, a model that increases cost and decreases ad revenue inevitably leads to higher consumer prices. That is why expanded basic is rightly, and so widely, perceived to be more economically efficient and better for consumers.

There is a broad and authoritative consensus that a la carte is not the answer. A completely independent study conducted by the General Accounting Office did not embrace a la carte. The leaders of popular American sports organizations including Major League Baseball, The National Hockey League, The National Football League and The Big Ten Conference all submitted letters to the FCC opposing a la carte. Ten leading economists including Gustavo Bamberger, Michael Baumann, Jay Ezrielev, John Gale, Tom Hazlett, Michael Katz, Kent Mikkelsen, Jonathon Orszag, Bruce Owen and Robert Willig, representing a broad cross-section of economic philosophy, filed with the FCC stating that a la carte distribution "would harm consumers, programmers, MVPDs, and overall economic efficiency."

Various financial analysts have similarly concluded that a la carte makes little sense for consumers or as a business proposition. A December 2005 Sanford Bernstein report noted that if Viacom's BET service was offered a la carte and every African-American family in America (17 percent of our population) subscribed to it, "its monthly price (i.e., affiliate fee) would need to rise by 588 percent for BET to remain revenue neutral. If just half opted in—still a wildly optimistic scenario—then the price would rise by 1,200 percent."

It is for this reason that in addition to these groups, the Congressional Black Caucus * and others concerned with the diversity of voices in our media have also raised strong opposition to a la carte. Niche programming services will clearly suffer or cease to be available in an a la carte world.

The Bernstein reports sums it up as follows:

> "The result would be monthly cable bills similar to today's but with each customer receiving a small number of channels for roughly the same total price as the large number they get today. Many niche programming options would cease to exist. And new channel launches would likely stop altogether (who would opt for a channel they never heard of?)."

* Letter has been retained in Committee files.

But you don't need to rely on economic theory or analysis. Disney has actual experience with a la carte distribution of the Disney Channel and we can confirm that expanded basic distribution produces far greater consumer welfare. Originally Disney Channel was offered a la carte available only to those children and families who could afford to pay an additional $10 to $16 dollars per month just for it. Despite the strength of the Disney brand, penetration hovered on average in the 9–10 percent range. Subscriber turnover ran about 5 percent to 6 percent per month or more than 60 percent per year requiring massive promotional expenditures to replace lost subscribers. Today, Disney Channel is offered on expanded basic in more than 87 million cable and satellite homes. This expanded distribution has enabled us to improve our programming, increase our ratings and serve a broad and diverse cross section of American families.

In sum, the GAO, America's major sports institutions, 10 leading and diverse economists, Wall Street and Disney's own experience all demonstrate that a la carte is not the answer.

Turning to the allegation of "bundling" channels, I want to assure you that the most popular ABC, ESPN and Disney services can be licensed individually by cable and satellite operators. An operator that wishes to carry just ESPN or just ABC or just Disney Channel may do so without any obligation to carry any other service or network that we own. Of course, like any other American business, the more of our services you buy, the more flexible we will be on pricing and the more overall value we will bring.

Turning to retransmission consent, some have argued that retransmission consent is a government intervention into the free market that is causing unanticipated consequences. Nothing could be further from the truth. The only requirement of this law is that before one business entity commercially exploits the product of another business entity, it must negotiate for permission. It is hard to imagine a more fundamental principle of American business. In its report on the Cable Television Consumer Protection Act of 1991, this Committee observed that, "cable systems use these [broadcast] signals without having to seek the permission of the originating broadcaster or having to compensate the broadcaster for the value its product created for the cable operation."[1] In explaining the new retransmission consent requirements, this Committee stated "cable operators pay for the cable programming services they offer to their customers; the Committee believes that programming services which originate on a broadcast channel should not be treated differently."[2] Further, this Committee specifically anticipated that the compensation paid by the cable operator to the broadcast station could take the form of "the right to program an additional channel on a cable system."[3]

Our opponents would have you believe that the broadcast networks dominate and abuse the retransmission consent process nationwide. But, this cannot be true. ABC owns only 10 television stations. The other 215 stations that comprise the ABC television network are owned by other broadcasting companies. As a result, our company is only involved in retransmission consent negotiations with cable and satellite operators in 10 markets across the country. We are not even in the room for the retransmission consent negotiation in the other 215 markets.

In the 10 markets where we do negotiate retransmission consent, we strive to strike a fair bargain. ABC invests more than $3 billion annually to create or acquire programming. It is plainly unreasonable for any distributor to expect to take that product and sell it to consumers without compensating us. We offer tremendous flexibility in the kinds of compensation that we are willing to accept. First, in the 10 markets where we are a part of the negotiation, we always offer a cash standalone option for carriage of just our ABC station. Notwithstanding an economic study that would support a significantly higher price, during the next retransmission consent cycle ending in 2008, our cash price remains under $1 a subscriber, an amount that is exceedingly reasonable by any marketplace comparison. That study by Economists, Inc. is supported by three different analytic approaches.*

Unfortunately, immediately after the enactment of retransmission consent, the major cable operators announced that they would not pay cash retransmission consent fees to broadcasters. For example, on August 18, 1993, the *Wall Street Journal* reported that "nearly all of the Nation's largest cable operators have vowed to forego paying cash to local TV stations." This prospective refusal to pay cash for retransmission rights was so uniform that the Co-Chairman of this Committee, Senator Inouye, asked the Justice Department and the Federal Trade Commission to inves-

[1] Senate Report 102–92, Cable Television Consumer Protection Act of 1991 at 35.
[2] *Id.*
[3] *Id.*
* The information referred to has been retained in Committee files.

tigate whether the cable companies had violated anti-trust laws by improperly colluding with each other. Faced with the refusal of cable operators to pay cash, broadcasters accepted from operators the opportunity to program other channels as the consideration for broadcast retransmission rights. Broadcasters bargain for carriage of local news channels, local weather channels or other channels that they own. The facts are clear. The practice of granting broadcast retransmission consent in return for carriage of commonly owned cable channels (1) is simply an alternative to the always available cash stand-alone option; (2) was specifically anticipated and approved in the Senate report; and (3) was insisted on by the cable operators themselves.

Finally, in our retransmission consent negotiations we have been extraordinarily flexible with smaller operators. Currently, we have over 100 separate agreements in place with small operators dealing with over a dozen Disney or ESPN product lines, covering everything from linear program services to broadband and pay per view. A couple of small operators have even agreed to pay cash for retransmission consent. Our mission is clear: to get these deals done using a reasonable approach in each circumstance and we have been quite successful in that effort. That is not surprising given the value of the programming we produce and the very positive relationship we have built with the small operator community and the National Cable Television Cooperative (NCTC). While each retransmission consent negotiation has traditionally been handled on an individual system or company basis, the overall relationship we have cultivated with the NCTC over many years is reflected in the umbrella purchasing agreements we have with them for rights to our non-broadcast programming services. Through those agreements, its members, representing 8 million subscribers, get the same volume discount opportunities we offer our large MSO customers in negotiations for our cable and satellite products and services.

Thank you.

The CHAIRMAN. Thank you very much. And all statements will be printed in full in the record. Sorry, I forgot the button, myself. We will print all the statements in the record that you have, gentlemen, but I appreciate the attachment to this. This also would be kept in the record.

Our next witness is Matt Polka, president of the American Cable Association. Thank you.

STATEMENT OF MATT POLKA, PRESIDENT/CEO, AMERICAN CABLE ASSOCIATION

Mr. POLKA. Thank you, Mr. Chairman and Members of the Committee.

My name is Matt Polka, and I am the President and CEO of the American Cable Association. ACA represents 1,100 smaller and medium-sized cable companies providing video, data, and telephone service in smaller markets and rural areas in every State. Today, I will focus my remarks on retransmission consent.

For ACA members and the rural customers they serve, the main problem is this. Broadcasters' escalating retransmission consent demands are resulting in higher cable costs, less choice, and carriage of unwanted channels. Today, powerful networks and affiliate groups are demanding ever-increasing retransmission consent payments from smaller cable companies. That payment may be in the form of cash-for-carriage. The price is not determined by market forces; rather, it depends on the size and market power of the broadcaster. When you're a small cable operator, you get squeezed the hardest.

The price may also come in the form of unwanted satellite programming channels tied to retransmission consent. To gain access to local broadcast signals, we and our customers have to pay for those unwanted channels. In the current round, we estimate, in our service areas alone, that these demands are adding between $500 and $800 million to the cost of basic cable. This amounts to a transfer of wealth from our rural customers to corporate headquarters in New York, Los Angeles, and elsewhere.

Broadcasters claim that retransmission consent preserves localism in this regard. But this is cynical, because how does forced carriage of unwanted channels and sharply rising cable costs preserve localism? It does not. Here is the part of the problem that is not well understood. At the same time broadcasters are demanding escalating retransmission consent prices, they are using regulations and contracts to exclude access to lower-cost substitutes. The results are predictable: prices go up, consumers pay more for the same channels.

An example: Take one of our members in a market where Disney owns the ABC station. The company serves a few thousand subscribers on the outskirts of the market. Disney is reportedly demanding either 85 cents per subscriber per month or requiring that the company add, and pay for, multiple Disney-controlled channels and Internet content. This small company could pick up ABC from a neighboring market at a lower price. The problem? Disney/ABC blocks access to the out-of-market station. By contrast, in the rare circumstances where a small cable operator can get access to an out-of-market station, the price for the in-market station comes down.

More and more voices are calling for retransmission consent reform, including smaller telephone companies represented by OPASCO and the very important rural telephone co-ops represented by the National Telecommunications Cooperative Association. Two weeks ago, you heard from our biggest competitor, EchoStar, saying the same. Just yesterday, an independent study issued by Arlen Communications confirmed that broadcasters are exploiting the current retransmission consent regime. The study describes how broadcasters' use of exclusivity and escalating demands are hurting consumers in smaller markets, and, in some areas, are impeding the roll out of broadband services.

Another key point from the Arlen study: Broadcasters gain more than $4 per subscriber per month in advertising revenues from the subscribers delivered by cable. This suggests that broadcasters should be paying cable for carriage, not the other way around.

To remedy these problems, we ask that Congress reform the retransmission consent laws in several ways:

First, when broadcasters seek a price for retransmission consent, allow us a right to shop. ACA members want to carry local signals, but when the price is artificially inflated, we should be allowed to consider neighboring markets. You need to break down the barriers of exclusivity so that the marketplace can moderate retransmission consent demands. As everybody knows, it pays to shop.

Second, apply the FCC's News Corp conditions to all broadcasters. Under the FCC's conditions imposed on the DIRECTV deal, FOX cannot pull its signal during the course of negotiations. This single condition has made those negotiations more orderly and reasonable. This condition should apply to all broadcasters when dealing with small- and medium-sized cable companies.

Finally, ACA members would like to offer more choices to consumers using tiers, including family-friendly offerings which are important to this Committee. The problem is that we can't. The tying and bundling practices of the media conglomerates prevent it. We need your help to make this possible.

In conclusion, ACA supports this Committee's work to address concerns about content, cost, and choice. However, it has become increasingly clear that without Congressional or regulatory involvement, broadcasters will continue to use scarce public spectrum, granted for free, to extract ever-increasing profits from rural consumers.

Thank you.

[The prepared statement of Mr. Polka follows:]

PREPARED STATEMENT OF MATT POLKA, PRESIDENT/CEO, AMERICAN CABLE ASSOCIATION

Thank you, Mr. Chairman and Members of the Committee. My name is Matt Polka, and I am the President and CEO of the American Cable Association. ACA represents 1,100 smaller and medium-sized cable companies providing advanced video, high-speed Internet access and telephone service in smaller markets and rural areas in every state.

I appreciate the opportunity to speak to you today and will focus most of my remarks on retransmission consent. As I will explain, especially when dealing with smaller cable companies, broadcasters' escalating retransmission consent demands are resulting in higher cable costs, less choice, and, in some cases, required carriage of objectionable content. I will also address the related problem of forced bundling and tie-ins—how the major media conglomerates require us to distribute, and our customers pay for, channels that our customers do not want. We believe the current system of regulations have unintentionally fostered much of the trouble. We also believe practical solutions exist and look forward to sharing our ideas with you today.

Unique Perspective

ACA brings a unique perspective to this hearing. Our members are smaller cable providers that do not own programming or content, and that are not affiliated with large media companies. This independence enables us to see what's good and what's bad in the current video market without being blinded by competing and conflicting interests that many of the vertically integrated companies face. Our sole mission is simple: we want to deliver high-quality advanced services and desirable programming that our local communities want.

Obsolete Laws and Regulations

We believe that current laws and regulations inhibit our ability to best serve our customers, who also happen to be your voters. After 20 years in the cable business, I have seen increasingly how retransmission consent abuse and wholesale programming practices impede our ability to best serve our local communities. To help remedy this, I urge you to continue your inquiry into video programming, pricing, and packaging. In doing so, I know Congress can benefit consumers by spurring innovation, competition, and flexibility.

Mr. Chairman, the crux of our concerns comes from the unfortunate and unintended consequences of the retransmission consent regime, a law governing the carriage of local broadcast television stations that was put into place in the 1992 Cable Act. In the 14 years since its enactment, the world of media has fundamentally changed. Through unprecedented consolidation, broadcasters and media companies have become much more powerful. When dealing with smaller cable companies, broadcasters no longer need the protection given them in 1992. Now, broadcasters are using retransmission consent in ways that restrict choice, raise costs, and force consumers to take channels they don't want. Retransmission consent today as used by the media giants, hurts "localism" rather than enhances it. Retransmission consent continues to be the root cause of the primary concern of so many: increasing consumer rates for cable and satellite television.

Just yesterday, an independent study issued by Arlen Communications confirmed that broadcasters are exploiting the current retransmission consent regime when dealing with smaller providers. The Arlen study describes how broadcasters use of exclusivity and escalating demands are hurting consumers in smaller markets and, in some areas, impeding the rollout of broadband. I encourage you and your staffs to give careful consideration to the Arlen report.

Retransmission Consent "Payment"

Under the current retransmission consent regime, powerful networks and affiliate groups demand payment from cable providers for their broadcast network. That "payment" may be in the form of cash-for-carriage, which for ACA members is often an astronomical price unfettered by any correlation with actual, identifiable market value, or cable operators may "choose", and pay for, affiliated non-local programming on their cable system. If cable operators opt to carry affiliated programming on their system, programmers dictate channel placement and set minimum penetration requirements that leave our members with no option but to include the affiliated programming on the expanded basic lineup. In other words, their "must-have" broadcast network that has been granted extensive protections by Congress in order to preserve "localism" now gives them leverage to force the carriage of their affiliated programming onto our channel lineup and into our consumers' homes.

Here is the part of the problem that is not well understood: While broadcasters are demanding escalating retransmission consent prices, at the same time they are using regulations and contracts to exclude access to lower cost substitutes. Put another way, retransmission consent "prices" are not disciplined by a competitive market. The result is predictable, prices go up and consumers are harmed. In short, broadcasters have gamed a system that has its roots in legal and regulatory fiat, not market-based mechanisms. We urge you to change that situation.

Family Tiers/Programming Contracts

With regards to children's programming, I want to commend those cable operators like Time Warner and Comcast who are working to offer a family-friendly tier to answer this Committee's call to clean up the airwaves. My members are ready and willing to offer the same service option, offering packages of customized content based on the markets we serve. However, our lack of clout with the programmers whose contracts mandate carriage of their channels does not allow our members to offer tiers and we are still trying to find a way to provide new tiers of service that does not put us in legal jeopardy with our programming partners. The programming conglomerates will have to loosen their vice-grip on tying and bundling, and lower their penetration requirements before more tiering choices can ever become the norm in the cable and satellite pay-television marketplace.

I believe nothing exemplifies the severity of this problem more than the fact that ACA shares the same views on this matter as EchoStar, one of our biggest competitors. EchoStar has the same unfortunate experience in retransmission consent negotiations as ACA members because they, too, do not own programming, and therefore do not have market leverage when negotiating with the media conglomerates.

In fact, contractual obligations have already had a negative impact on the family-friendly tiers being rolled out by Time Warner and Comcast. Members of this Committee noted at the indecency hearing held just two weeks ago that while the tiers were a step in the right direction, they were limited in the channels they offered. There was concern among some Senators who observed the lack of marketability in the tiers that offered G-rated programming only and eliminated sports altogether from the package. What the cable companies who are offering the tiers didn't tell you, most likely due to the non-disclosure agreements in their contracts, is that these are the only channels the conglomerates would allow them to offer on such a tier! Furthermore, those companies offering family-friendly tiers are already saying they will have to cap the number of subscribers that can sign up for the family friendly tier. That is because if too many consumers want this offering, they will not meet their contractual penetration obligations dictated by the programming owners. I'm sure the programmers are not about to waive their penetration requirements for us should family friendly tiering become popular. However, if you can ask them if they would release us from those obligations so that we can meet your call for more family oriented programming tiers, we would be able to offer a much more robust and appealing suite of programs to your constituents.

There was also question at the indecency hearing as to why the market cannot determine what is offered on tiers. We at ACA have the exact same question. We, who live and work in the communities we serve, believe we should have the ability to answer our consumers' desires and the market's demand by offering the channels our subscribers want to watch. Instead, it is the tying and bundling of programming in the take-it-or-leave-it contracts extended to us by the conglomerates in Hollywood and New York that determine what is offered on the lineup of the cable television in the 8 million, predominantly rural homes we serve across America.

I know the issue of indecency on television has been one of recent concern to this Committee, and in particular to you, Chairman Stevens. Let me point out that the most objectionable and adult-oriented channels on our lineup are carried because they are tied to one of the must-have broadcast networks that is broadcast on public airwaves, or even more alarming, are tied to the carriage of popular children's programming, as in the case of Logo, the gay and lesbian network, being tied to one of the Nickelodeon services.

Additionally, in many markets today a cable or satellite provider that wants to carry family programming, such as Nickelodeon, must also carry much more suggestive and sexually explicit programming on MTV and Spike TV, AND must put that programming on the same tier as the children's programs! Essentially, to get *Spongebob Squarepants*, a well-known children's program, cable and satellite providers and their customers have to also take *Undressed* or *Stripperella*, two highly sexual, adult programs. Here's what MTV's website says about its program, *Undressed*: "Not getting enough action before you go to bed? *Undressed* will definitely be changing that! This season is sure to titillate your senses—so tune in!" Did Congress intend to perpetuate this type of situation and allow the use of the public airwaves to be used as leverage to carry such programming?

A la Carte

I must say there is great irony in the recent announcement that companies like Time Warner and Comcast will offer a family-friendly tier. The programmers and MSOs have said for years that tiers and a la carte offerings would destroy economic models, and have dismissed the notion that offering such services could ever happen. With pressure from this Committee and the real threat of legislative action, their strident position managed to change within a week's time. Furthermore, these same programmers, who were the strongest opponents of flexible, market-based offerings, are now selling their individual programming on iTunes, where customers can go online and download an individual program and watch it on their handheld iPod device. I believe most casual observers would call this kind of offering "a la carte" as it allows consumers not to select just the network they want to watch, but the specific program they desire. While ACA has called for greater marketplace innovation and flexibility to distribute programming to consumers, programmers have historically forced us to distribute the one size, take-it-or-leave-it offerings because they claimed any other model would destroy the fragile balance that they rely upon to stay profitable. Hopefully, now Congress and the FCC realize that the market is much more resilient than they had claimed and no longer has to take our word for it, they can see it in the actions of the programmers themselves.

And certainly networks can't really fight to keep retransmission consent in its current form for the sake of preserving localism: not when they are selling their prime programming product they produce for free over-the-air television and bypass their own affiliates. They are selling their highest-rated programming stripped of any local advertising and without giving the affiliate a share of the $1.99 charged to the consumer for the download. As the market moves toward this model, there is no doubt affiliates' ad revenues will be reduced as viewers no longer need to watch their station to view their prime programs, which will eventually have an impact on the quality of local news and services offered by those affiliates.

How does this approach protect "localism?" It appears to me that nothing may imperil the financial viability of local stations more than this new business model. The conglomerates have undermined their own argument that they are for localism and they should no longer be able to use the tool of retransmission consent to hide their interests. In fact, the localism they worry so much about is safe due to another regulatory tool that should be retained. The ACA believes that "must carry" should remain the governmentally-granted tool to ensure that local stations are not shut out from any market.

Cash or Tying

Today, programmers have two sources of revenue: one is the fees they charge operators to gain access to the programming and the other comes from the advertising fees they charge. For this reason, the programmers demand channel placements on basic or expanded basic tiers in order to get their offerings in front of the maximum number of eyeballs possible, which helps drive up their advertising profit. The largest programmers who have broadcast and cable channels effectively bypass market forces and bundle their broadcast channels with their affiliated programming, and force distributors to charge consumers for channels they don't even want—and in many questions, channels they find objectionable. If an operator opts out of the retransmission consent agreement and wants to take a stand-alone channel, the cash-for-carriage demand is most often an unreasonable price with no market basis, and is significantly greater than the price of the bundle of channels offered. To make matters worse, those programmers demanding such costs, channel placement, and carriage of additional channels are able to hide behind nondisclosure provisions in their contracts, further complicating the ability to address the abuse of retransmission consent practices.

Price Discrimination

Additionally, the wholesale price differentials between what a smaller cable company pays in rural America compared to larger cable operators in urban America have little to do with differences in cost, and much to do with disparities in market power. These differences are not economically cost-justified and could easily be replicated in the IP world as small entrants are treated to the same treatment our members face.

For instance, ACA members have reported wholesale programming price differentials between smaller companies and major cable companies of up to 30 percent, and in one case, 55 percent. In this way, smaller cable systems and their customers actually subsidize the programming costs of larger urban distributors and consumers! We even end up with worse pricing than satellite companies DIRECTV and EchoStar, who are the main competitors to our rural cable systems. Price discrimination against smaller cable companies and their customers is clearly anti-competitive conduct on the part of the programmers—they offer a lower price to one competitor and force another other competitor to pay a 30–55 percent higher price FOR THE SAME PROGRAMMING. The effect of these practices by the programmers is that three MVPDs in the same town pay wildly different rates for the same product that each is distributing in that town.

Forced Carriage Eliminates Diverse Programming Channels

The practices of certain programmers have also restricted the ability of some ACA members to launch and continue to carry independent, niche, religious and ethnic programming. The main problem: requirements to carry programmers' affiliated programming on expanded basic eliminate "shelf space" where the cable provider could offer independent programming.

If video providers are to provide outlets for niche programming that appeals in their markets (i.e., Spanish communities), you must ensure that they are not subject to the handcuffs current law allows to be placed upon them. The programmers argue that their affiliated programming would not get carriage without retransmission consent, which would minimize subscribers' viewing choices. However, there are numerous independent channels that want to be carried but do not have a broadcast network to bundle with their channel. Even if they present programming a cable operator wants to launch in his market area, he often does not have the "shelf space" to do so because of the forced carriage of affiliated programming by the programmers. If the programmers are so certain they have valuable programming, why are they so relentless in their fight to preserve their right to tie their affiliated programming to their broadcast network? Why not let the market determine what is desirable? If the programmers produce must-have content, consumers will demand it and cable operators will carry it. They should not be allowed to use their leverage of public airwaves to get carriage of affiliated programming.

Remedies

To fix this situation, Congress must update and reform: (1) the retransmission consent and (2) program access laws.

Retransmission Consent Reform

- *Smaller cable operators should have the "right to shop" for the most economical programming package to offer their subscribers*. Broadcasters use a combination of regulations and contracts to block cable operators from retransmitting stations from outside a broadcasters' market. Exclusivity is now being exploited by broadcasters to raise the cost of retransmission consent for smaller cable operators and their consumers. In other words, the conglomerate-owned station makes itself the only game in town, and can charge the cable operator a monopoly "price" for its must-have network programming. The cable operator needs this programming to compete. So your constituents end up paying monopoly prices.

ACA believes there is a ready solution to this dilemma. When a broadcaster seeks a "price" for retransmission consent, give small cable companies the ability to shop for lower cost network programming for their customers.

Accordingly, in its March 2, 2005 Petition for Rulemaking to the FCC, ACA proposed the following adjustments to the FCC's retransmission consent and broadcast exclusivity regulations:

One: Maintain broadcast exclusivity for stations that elect must-carry or that do not seek additional consideration for retransmission consent.

Two: Eliminate exclusivity when a broadcaster elects retransmission consent and seeks additional consideration for carriage by a small cable company.

Three: Prohibit any party, including a network, from preventing a broadcast station from granting retransmission consent to a small cable company.

On March 17, 2005, the FCC released ACA's petition for comments. By opening ACA's petition for public comment, the FCC has acknowledged that the current retransmission consent and broadcast exclusivity scheme requires further scrutiny. Before codifying a new regulatory regime for video services utilizing IP, Congress should ask similar questions and make the important decision to update current law to rebalance the role of programmers and providers.

- *Tying through retransmission consent must end.* The law should prevent the media giants from holding local broadcast signals hostage for monopolistic cash-for-carriage demands or more carriage of affiliated media-giant programming, which was never the intention of Congress when granting this power.
- *Codify the News-Hughes conditions made by the FCC when approving the News Corp acquisition of DIRECTV.* The FCC acknowledged the disproportionate market power News Corp would have as a programmer and a distributor when they sought to acquire DIRECTV. The FCC imposed conditions on News Corp. to apply during their retransmission consent negotiations. The three key components of those conditions include: (i) a streamlined arbitration process; (ii) the ability to carry a signal pending dispute resolution; and (iii) special conditions for smaller cable companies. ACA believes conditions like these applied to smaller and medium-sized cable operators would improve the current retransmission consent process.

Program Access Reform

- *Price discrimination must end.* The programming pricing gap between the biggest and smallest providers must be closed to ensure that customers and local providers in smaller markets are not subsidizing large companies and subscribers in urban America. The programming media giants must disclose, at least to Congress and the FCC, what they are charging local providers, ending the strict confidentiality and nondisclosure dictated by the media giants. Confidentiality and nondisclosure mean lack of accountability of the media giants.
- *Transparency must be created* if consumer rates are of concern to you. Most programming contracts are subject to strict confidentiality and nondisclosure obligations, and ACA members are very concerned about retaliation by certain programmers should they discuss the specifics of any deal. For instance, if you ask me today what a specific ACA member pays a certain programmer, I could not tell you without fearing legal action by the media giant. Programmers could agree to waive nondisclosure for purposes of this hearing or even in our contracts, but they never do. Ask them today, and I'd be shocked if they would disclose specific terms and conditions. Ask them why this confidentiality and nondisclosure exists.

Who does it benefit? Consumers, Congress, the FCC? I don't think so. Why is this information so secret when much of the infrastructure the media giants benefit from derives from licenses and frequencies granted by the government?

Congress should obtain specific programming contracts and rate information directly from the programmers, either by agreement or under the Committee's subpoena power. That information should then be compiled, at a minimum, to develop a *Programming Pricing Index (PPI).* The PPI would be a simple yet effective way to gauge how programming rates rise or fall while still protecting the rates, terms, and conditions of the individual contract. By authorizing the FCC to collect this information in a manner that protects the unique details of individual agreements, I cannot see who could object.

Armed with this information, Congress and the FCC would finally be able to gauge whether rising cable rates are due to rising programming prices as we have claimed or whether cable operators have simply used that argument as a ruse. A PPI would finally help everyone get to the bottom of the problems behind higher cable and satellite rates.

Conclusion

In conclusion, let me reiterate that ACA members are eager to offer their customers more choices and lower costs. Today, broadcasters and programmers prevent that. The roll-out of family-friendly tiers two weeks ago proved that more consumer choice is achievable, and with help from this Committee, I believe we as operators can do more to create marketable tiers of programming. The retransmission consent and broadcast exclusivity regulations have been used by the networks and stations to raise rates and to force unwanted programming onto consumers. This must stop. If a station wants to be carried, it can elect must-carry. If a station wants to charge for retransmission consent, let a true competitive marketplace establish the price.

Mr. Chairman, ACA members would prefer mutually beneficial carriage arrangements with programmers. For this to occur, certain media conglomerates would need to temper economic self-interest with a heightened concern for the public interest in localism, consumer choice, and reasonable cable rates. However, it has become increasingly clear that without congressional or regulatory involvement, these companies will continue to abuse retransmission consent using scarce public spectrum granted them for free to extract ever-increasing profits from rural consumers.

The CHAIRMAN. Thank you.

Senator Dorgan just arrived.

Did you have an opening statement, Senator?

Senator DORGAN. I'll wait for the witnesses, Mr. Chairman.

The CHAIRMAN. Thank you very much.

Our next witness is Robert G. Lee, President and General Manager at WDBJ Television of Roanoke.

Sir?

STATEMENT OF ROBERT G. LEE, PRESIDENT/GENERAL MANAGER, WDBJ TELEVISION, INC.; ON BEHALF OF THE NATIONAL ASSOCIATION OF BROADCASTERS

Mr. LEE. Thank you, Chairman Stevens.

My name is Bob Lee, and I am President and General Manager of WDBJ Television, a family-owned station in Roanoke, Virginia.

I'm testifying today on behalf of the National Association of Broadcasters, of which I am also a board member. NAB, as you know, is a trade association that advocates on behalf of more than 8,300 free, local, over-the-air radio and television stations, as well as the broadcast networks, before Congress, the FCC, and occasionally before the courts.

Before the Cable Act, cable operators were not required to seek the permission of a broadcaster before carrying its signal, and cable was not required to negotiate for reselling broadcasters' signals. Cable companies would just pick up a local station's programming and leverage it to attract subscribers. Then operators would use those subscriber fees to create new cable channels that would directly compete with local broadcasters for advertising dollars, our sole means of support. In short, Congress and the FCC found that local television stations were being forced to subsidize our competitors.

Congress corrected this imbalance by creating a marketplace in which broadcasters could negotiate for cable's use of our programming. The retransmission consent system is, in fact, working, and consumers have been the ultimate beneficiaries.

But don't take that from me. Listen to the expert agency. The FCC's report from September of 2005 recommended no changes to the existing structure, and the Commission found that the retransmission consent process is fair. The report states, "As a general rule, the local television broadcaster and the MVPD negotiate in the context of a level playing field." In light of this report, complaints from my cable friends ring hollow.

ACA, you see, wants it both ways. On one hand, operators complain about paying broadcasters to use their signals. Yet, in the next breath, these same companies say that negotiating for carriage of additional programming is also unreasonable. Ironically, it was the cable industry's resistance to cash payments that resulted in cable companies carrying additional programming produced by the broadcaster as a form of consideration. And television viewers benefit from the innovative local programming offerings that have resulted.

A good example is here in Washington, where the ABC affiliate, Channel 7, through its retransmission consent agreement, has been able to expand its News/Channel 8, a local cable news network offering news, weather, and public-affairs programming. And Belo uses retransmission consent to obtain carriage of its regional cable news channel in serving viewers in Oregon, Washington, Montana, Alaska, California, and Virginia. And LIN Television uses retransmission consent to provide local weather information on separate channels carried by cable systems, just as my station does.

In short, retransmission consent enables broadcasters to offer viewers more locally oriented programming. Again, this is what Congress intended. In fact, this very Committee wrote, in its report on the Cable Act, that while some broadcasters would receive cash for their signals, other broadcasters would, "negotiate other issues with cable systems, such as the right to program an additional channel on a cable system."

Now, before I close, let me address two misconceptions. ACA contends that broadcasters wield inordinate market power in these negotiations because of their size. Well, the facts belie that argument, especially in smaller markets. And we're the 68th-largest market, so I can speak on this with some experience. In the 110 smallest cable television markets, a majority of cable subscribers are served by one of the four largest cable companies. By way of contrast, only about 3 percent of the television stations in these markets are owned by one of the top ten television groups. So, I ask, Who really has leverage in these negotiations?

Second, Mr. Polka's group released a study yesterday, as he said, arguing that broadcasters should pay cable operators for carriage of our signals. This study is riddled with flaws, but, in the interest of time, let me say this. On page 1, the study notes how valuable and essential broadcast signals are to cable companies. The rest of the study is then spent arguing that broadcasters should be paying cable to carry it. ACA wants it both ways. And that won't work.

In closing, Mr. Chairman, ACA would ask that we turn back the clock to the "bad old days" when cable got their broadcast signals for nothing and got their kicks for free. Such an unfair arrangement would put free local television, our viewers, your constituents, in very dire straits, indeed.

Thank you.

[The prepared statement of Mr. Lee follows:]

PREPARED STATEMENT OF ROBERT G. LEE, PRESIDENT/GENERAL MANAGER, WDBJ TELEVISION, INC.; ON BEHALF OF THE NATIONAL ASSOCIATION OF BROADCASTERS

Good afternoon, Chairman Stevens, Co-Chairman Inouye, and Members of the Committee, my name is Robert G. Lee. I am President and General Manager of WDBJ Television, the CBS affiliated station in Roanoke, Virginia. As a local broadcaster, I have firsthand experience with the issues being discussed by the Committee at this hearing. I am also a member of the Television Board of Directors of the National Association of Broadcasters (NAB). NAB is a trade association that advocates on behalf of more than 8,300 free, local radio and television stations and also broadcast networks before Congress, the Federal Communications Commission and the Courts.

From their hollow complaints about the alleged unfairness of retransmission consent, multichannel video programming distributors (MVPDs) clearly want to have their retransmission cake and eat it to. In one breath, MVPDs complain that broadcasters are unreasonable in negotiating cash payment for carriage of their local signals; in the next, they claim that negotiating for carriage of additional programming is also unreasonable. In essence, MVPDs argue that retransmission consent is invalid simply because broadcasters should give away their signals to MVPDs without compensation in any form. But there is no reason that broadcasters—unique among programming suppliers—should be singled out not to receive compensation for the programming provided to MVPDs. This is especially true today, given the rapidly increasing competition by MVPDs with broadcasters for national and local advertising revenue.

Congress Established Retransmission Consent to Create a Marketplace in Which Broadcasters Could Negotiate for Compensation for MVPDs' Use of Their Signals

Because Congress created the retransmission consent marketplace nearly 15 years ago, I begin my testimony by reminding us all here today why Congress granted broadcasters retransmission consent rights in the first instance. In short, Congress adopted retransmission consent to ensure that broadcasters had the opportunity to negotiate in the marketplace for compensation from MVPDs retransmitting their signals. As the Federal Communications Commission (FCC) recently concluded, retransmission consent has fulfilled Congress' purposes for enacting it and has benefited broadcasters, MVPDs and consumers alike.

Prior to the Cable Television Consumer Protection and Competition Act of 1992, cable operators were not required to seek the permission of a broadcaster before carrying its signal and were certainly not required to compensate the broadcaster for the value of its signal. At a time when cable systems had few channels and were limited to an antenna function of improving the reception of nearby broadcast signals, this lack of recognition for the rights broadcasters possess in their signals was less significant. However, the video marketplace changed dramatically in the 1970s and 1980s. Cable systems began to include not only local signals, but also distant broadcast signals and the programming of cable networks and premium services. Cable systems started to compete with broadcasters for national and local advertising revenues, but were still allowed to use broadcasters' signals—without permission or compensation—to attract paying subscribers.

By the early 1990s, Congress concluded that this failure to recognize broadcasters' rights in their signals had "created a distortion in the video marketplace." S. Rep. No. 92, 102d Cong., 1st Sess. at 35 (1991) (*Senate Report*). Using the revenues they obtained from carrying broadcast signals, cable systems had supported the creation of cable programming and services and were able to sell advertising on these cable channels in competition with broadcasters. Congress concluded that public policy should not support "a system under which broadcasters in effect subsidize the establishment of their chief competitors." *Id*. Noting the continued popularity of broadcast programming, Congress also found that a very substantial portion of the fees that consumers pay to cable systems is attributable to the value they receive from watching broadcast signals. *Id*. To remedy this "distortion," Congress in the 1992 Cable Act gave broadcasters control over the use of their signals and permitted broadcasters to seek compensation from cable operators and other MVPDs for carriage of their signals. *See* 47 U.S.C. § 325.

In establishing retransmission consent, Congress intended to create a "marketplace for the disposition of the rights to retransmit broadcast signals." *Senate Report* at 36. Congress stressed that it did not intend "to dictate the outcome of the ensuing marketplace negotiations" between broadcasters and MVPDs. *Id*. Congress correctly foresaw that some broadcasters might determine that the benefits of carriage were sufficient compensation for the use of their signals by cable systems. *Id*. at 35. Some broadcasters would likely seek monetary compensation, while others, Congress explained, would "negotiate other issues with cable systems, such as joint marketing efforts, the opportunity to provide news inserts on cable channels, or the right to program an additional channel on a cable system." *Id*. at 36.

Thus, even at the outset, Congress correctly recognized that, in marketplace negotiations between MVPDs and broadcasters, stations could appropriately seek a variety of types of compensation for the carriage of their signals, including cash or carriage of other programming. And while retransmission consent does not guarantee that a broadcaster will receive fair compensation from an MVPD for retransmission of its signal, it does provide a broadcaster with an opportunity to negotiate for compensation.

The FCC Recently Recommended That No Revisions Be Made to Retransmission Consent Policies

After some years' experience with retransmission consent, Congress in late 2004 asked the FCC to evaluate the relative success or failure of the marketplace created in 1992 for the rights to retransmit broadcast signals. This evaluation shows that MVPDs' complaints about retransmission consent disadvantaging them in the marketplace or somehow harming competition are groundless. In its September 2005 report to Congress about the impact of retransmission consent on competition in the video marketplace, the FCC concluded that the retransmission consent rules did not disadvantage MVPDs and have in fact fulfilled Congress' purposes for enacting them. The FCC accordingly recommended no revisions to either statutory or regulatory provisions relating to retransmission consent. FCC, *Retransmission Consent and Exclusivity Rules: Report to Congress Pursuant to Section 208 of the Satellite Home Viewer Extension and Reauthorization Act of 2004* (Sept. 2005) (*FCC Report*).

In its report, the FCC concluded that local television broadcasters and MVPDs conduct retransmission consent negotiations on a "level playing field." *Id*. at ¶ 44. The FCC observed that the retransmission consent process provides incentives for both broadcasters and MVPDs to reach mutually beneficial arrangements and that both parties in fact benefit when carriage is arranged. *Id*. Most importantly, according to the FCC, consumers benefit by having access to the broadcasters' programming carried via MVPDs. *Id*. Overall, the retransmission consent rules have, as Congress intended, resulted in broadcasters being compensated for the retransmission of their stations by MVPDs and MVPDs obtaining the right to carry broadcast signals. *Id*.

Given these conclusions, the FCC recommended no changes to current law providing for retransmission consent rights. Moreover, the FCC explained that the retransmission consent rules are part of a "carefully balanced combination of laws and regulations governing carriage of television broadcast signals." *Id*. at ¶ 45. Thus, if Congress were to consider proposals to restrict broadcasters' retransmission consent compensation, the FCC cautioned that review of other rules, including must carry and copyright compulsory licensing, would be necessary as well "to maintain a proper balance." *Id*. at ¶¶ 33, 45.

MVPDs' Complaints About Retransmission Consent Are Groundless

Especially in light of this recent FCC report, the various repetitive complaints of MVPDs about the alleged unfairness of retransmission consent ring hollow. For instance, some cable operators have complained about the retransmission consent fees purportedly extracted from them by broadcasters. These complaints are especially puzzling because, as the FCC recently reported, cable operators have in fact consistently refused to pay cash for retransmission consent. *FCC Report* at ¶¶ 10, 35. As a result, "virtually all" retransmission consent agreements have involved "a cable operator providing in-kind consideration to the broadcaster," and cash is not yet "a principal form of consideration for retransmission consent." *Id*. at ¶ 10. This in-kind consideration has included the carriage of affiliated nonbroadcast channels or other consideration, such as the purchase of advertising time, cross-promotions and carriage of local news channels. *Id*. at ¶ 35. Given that cable companies rarely pay cash for retransmission consent of local broadcast signals, this Committee should reject any MVPD claims that broadcasters' retransmission consent fee requests are unreasonable or are somehow the cause of continually increasing cable rates. In fact, in late 2003, a General Accounting Office study did not find that retransmission consent has lead to higher cable rates. *See* GAO, *Issues Related to Competition and Subscriber Rates in the Cable Television Industry*, GAO–04–8 at 28–29; 43–44 (Oct. 2003).

Complaints from MVPDs that some broadcasters attempt in retransmission consent negotiations to obtain carriage for additional programming channels are ironic, to say the least. As the FCC found, broadcasters began to negotiate for carriage of additional program streams in direct response to cable operators' refusal to pay cash for retransmission consent of broadcast signals. *FCC Report* at ¶ 10. Certainly any claims that cable operators somehow have been forced to carry unwanted programming as the result of retransmission consent are disingenuous. Under the retransmission consent regime, no cable operator is compelled to carry *any* channel, whether a local broadcast channel or an allegedly "bundled" programming channel. And if a cable operator prefers not to carry any channel beyond a broadcaster's local signal, cash alternatives are offered in retransmission consent negotiations. For example, EchoStar recently completed negotiations with Hearst-Argyle Television for a cash-only deal at a marketplace rate.

Clearly, MVPDs want to have their retransmission cake and eat it too. In one breath, MVPDs complain that broadcasters are unreasonable in requesting cash payment for carriage of their local signals; in the next, they assert that negotiating for carriage of additional programming is also unreasonable. In essence, MVPDs argue that retransmission consent is somehow inherently invalid because broadcasters should give their consent to MVPDs without compensation in any form. But there is no legal, factual or policy reason that broadcasters—unique among programming suppliers—should be singled out not to receive compensation for the programming provided to MVPDs, especially given MVPDs' increasing competition with broadcasters for advertising revenue. Indeed, when enacting retransmission consent, Congress noted that cable operators pay for the cable programming they offer to customers and that programming services originating on broadcast channels should be treated no differently. *Senate Report* at 35.

Some cable operators have also presented an inaccurate picture of the video marketplace by contending that, in rural areas and smaller markets, powerful broadcast companies have undue leverage in retransmission consent negotiations with local cable operators. This is not the case. The cable industry as a whole is concentrated nationally and clustered regionally and is dominated by a smaller and smaller number of larger and larger entities. This consolidation will only continue assuming that the pending acquisition of Adelphia Communications by Comcast and Time Warner is approved. In contrast, a strict FCC duopoly rule continues to prohibit broadcast television station combinations in medium and small markets. In fact, a majority of cable subscribers in Designated Market Areas 100+ are served by one of the four largest cable MSOs, while only about three percent of the television stations in these markets are owned by one of the top ten television station groups. Thus, in many instances in these 100+ markets, small broadcasters—which are facing severe financial pressures—must deal with large nationally and regionally consolidated MVPDs in retransmission consent negotiations. In sum, local broadcasters in medium and small markets do not possess unfair leverage over increasingly consolidated cable operators.

Indeed, in small and large markets alike, nationally and regionally consolidated MVPDs have been able to exert considerable market power in retransmission consent negotiations, at the expense of local broadcasters. In actual retransmission consent agreements, broadcasters have frequently had to accept a number of egregious terms and conditions, especially with regard to digital carriage.

For example, it is not uncommon for MVPDs in retransmission agreements to refuse to carry a station's multicast digital signal that contains any religious programming and/or any programming that solicits contributions, such as telethons or other charitable fundraising programming. MVPDs have refused to carry any digital multicast signal unless the channel is broadcasting 24 hours a day, seven days a week. This requirement is very difficult for most digital stations (especially small market ones) to meet, and thereby makes it virtually impossible for many stations to obtain carriage of digital multicast signals. Under other retransmission agreements, the MVPD agreed to carry only the high definition portion of a broadcast station's digital signal, and the carriage of any portion of the broadcaster's non-high-definition digital signal (including even the primary digital signal) remained entirely at the discretion of the MVPD. Other MVPDs have declined to carry the primary digital signals of non-big four network affiliated stations, unless these stations achieved certain viewer rankings in their local markets. Thus, the digital signals of many stations, including WB/UPN affiliates, Hispanic-oriented stations, religious stations and other independent stations, would not be carried by these MVPDs. It seems highly unlikely that broadcasters would accept such disadvantageous provisions in retransmission agreements, unless the MVPDs were in a sufficiently powerful marketplace position so as to insist on such provisions.

In light of these real-world examples, Congress should skeptically view any complaints from MVPDs as to how they are at the mercy of powerful broadcasters in marketplace retransmission consent negotiations. The current retransmission consent rules also already protect all MVPDs by imposing an affirmative obligation on broadcasters to negotiate in good faith and providing a mechanism to enforce this obligation. *See* 47 CFR § 76.65. In fact, EchoStar was the complainant in the only "good faith" case to be decided on the merits by the FCC. In that case, the broadcaster was completely exonerated, while EchoStar was found to have abused the FCC's processes. *EchoStar Satellite Corp*. v. *Young Broadcasting, Inc*., 16 FCC Rcd 15070 (2001). Unwarranted MVPD complaints about retransmission consent certainly cannot undermine the FCC's conclusion that MVPDs are not disadvantaged by the existing retransmission consent process. *See FCC Report* at ¶ 44.

Consumers Benefit From the Retransmission Consent Process

Finally, I would like to elaborate on the FCC's conclusion in its report that retransmission consent has benefited the viewing public, as well as broadcasters and MVPDs. As the FCC specifically noted, broadcasters' ability to negotiate carriage of additional programming through retransmission consent benefits viewers by increasing consumers' access to programming, including local news channels. *See FCC Report* at ¶35. One excellent example is Allbritton Communications Company's NewsChannel 8 here in the Washington metropolitan area. NewsChannel 8 is a local cable news network launched as a result of retransmission consent negotiations over the carriage of Allbritton's television station WJLA–TV. It provides local news, weather and public affairs programming, along with coverage of local public events. Further, this programming is zoned separately to better serve viewers in Washington, D.C., the Maryland suburbs and Northern Virginia.

Similarly, Belo used retransmission consent to obtain carriage of its regional cable news channel NorthWest Cable News (NWCN) on cable systems serving over two million households in Washington, Oregon, Idaho, Montana, Alaska and California. NWCN provides regional up-to-the minute news, weather, sports, entertainment and public affairs programming to viewers across the Northwest. These efforts are coordinated with Belo's television stations in Seattle, Portland, Spokane and Boise.

In addition to local news channels, broadcasters have used retransmission consent to provide local weather information on separate channels carried by cable systems. For example, LIN Television provides these local weather channels in several markets, including ones with a history of frequent weather emergencies such as Indianapolis. And beyond this use of retransmission consent to gain carriage for local news and weather channels, broadcasters have recently used retransmission consent negotiations to obtain carriage of their digital signals, thereby both benefiting viewers and, according to the FCC, furthering the digital transition. *See FCC Report* at ¶45.

Conclusion

As my testimony makes clear, Congress intended in the 1992 Cable Act to give broadcasters the opportunity to negotiate in the marketplace for compensation from MVPDs retransmitting their signals. The FCC concluded less than six months ago that retransmission consent has fulfilled Congress' purposes for enacting it, and recommended no changes to either statutory or regulatory provisions relating to retransmission consent. This Committee should accept the FCC's conclusion and continue to let broadcasters and MVPDs negotiate in the marketplace for retransmission consent. Especially in light of the FCC's conclusion that local broadcasters and MVPDs generally negotiate on a "level playing field," Congress has no basis for altering the retransmission consent marketplace. *FCC Report* at ¶44. Thank you for your time and attention this afternoon.

The CHAIRMAN. Thank you very much.

The next witness is Dan Fawcett, Executive Vice President for programming for DIRECTV——

What? Excuse me, I skipped you, Mr. Waz. I'm running through this day faster than I want to, I guess.

[Laughter.]

The CHAIRMAN. Or maybe I want to run through faster than I can.

[Laughter.]

The CHAIRMAN. I apologize.

Joseph Waz, Vice President of External Affairs at Comcast.

Mr. Waz?

STATEMENT OF JOSEPH W. WAZ, JR., VICE PRESIDENT, EXTERNAL AFFAIRS AND PUBLIC POLICY COUNSEL, COMCAST CORPORATION

Mr. WAZ. Thank you, Chairman Stevens. I'll try to keep it moving, as well. And I appreciate the opportunity to be here this afternoon.

Two years ago, the FCC said, "The vast majority of Americans enjoy more choice, more programming, and more services than at any time in history.” Today, that’s an understatement. Competition in video distribution and video content is booming, and that really is the heart of my testimony today.

Virtually every cable consumer in every community that Comcast serves can choose from at least three multichannel video providers, or MVPDs. Two DBS providers—DIRECTV, which is on the panel with me here today, and EchoStar—now serve over 27 million American homes nationwide. Both companies are larger than every cable company but Comcast. We also compete with providers like RCN and Knology, and with phone companies like Verizon and AT&T, which promise an aggressive entry into video.

Meanwhile, 15 to 20 million American homes still prefer to rely on broadcast television. Most Americans also rent and buy DVDs and videotapes in record numbers. And the competitive distribution outlets keep growing. From iPods to mobile phones to digital video recorders, everything is becoming a video device.

To respond to all of this competition, Comcast has invested over $40 billion to expand capacity so we can offer over 200 channels or more to our customers. We’ve added dozens of international, foreign language, and high-definition channels. We are the leaders in video-on-demand, which lets our customers choose what they want to watch, when they want to watch it, over 3,000 different choices today and growing fast. And on-demand is clearly the direction the world is heading.

This explosion of distribution outlets and channel capacity has ignited a corresponding explosion in video content. When the 1992 Cable Act was passed, there were only 68 national programming networks. Most were vertically integrated—that is, owned at least in part by a cable company. And that was largely because no one else would risk investing in them at the time.

Fast forward to 2006. Now there are 388 national programming networks and nearly 100 regional networks. Vertical integration has plummeted from 57 percent in 1992 to 23 percent today. And Comcast has a financial interest in only about 7 percent of the networks that we carry. So, there’s vastly more competition in content and distribution than there was in 1992.

Against that backdrop, let me review two rules that Congress adopted in that year: the program-access and program-carriage rules.

Program access was intended to help competitors to cable. It ensured that vertically integrated satellite-delivered programming services were available to competitors on terms and conditions comparable to those that were available to cable operators.

Program carriage was intended to help independent programmers. It ensured that, in an era when cable had little competition, cable companies could not unfairly block independent programmers from reaching consumers.

In adopting program-access requirements, Congress did not try to turn all programming into a commodity. The rules don’t apply to non-vertically integrated programming or to terrestrially distributed programming. Congress consciously limited the reach of the rules, and we think Congress knew exactly what it was doing.

Those rules have worked. Or, more accurately, the marketplace has worked. There have been fewer than 50 complaints on program access filed in 14 years. Almost none has led to an adverse ruling. In fact, most have been settled. And in recent years program-access complaints have dwindled.

Despite this record of success, DIRECTV and others have spent most of the past decade insisting the sky is falling. For a decade, they have warned that cable programming would be moved from satellite delivery to terrestrial delivery to evade the rules. For a decade, they've alleged that they would be denied programming. But the truth is, it didn't happen. Today, DIRECTV and every other competitor has access to more programming—sports, news, entertainment, and otherwise—than ever before.

The program-carriage rules have almost never been used—again, because the marketplace works. If you have an attractive programming idea, a sensible business plan, a willingness to negotiate terms that work for the programmer and the distributor, and something unique to the marketplace, you have the opportunity to build a business.

The America Channel has not filed a program-carriage complaint with the FCC, but they have used every other opportunity—and I think they'll be using this hearing today—to get the government to force Comcast to carry it.

I've addressed both of these situations in my written statement, but I would say, in brief, that there are so many competitive alternative distribution outlets available today that a carriage agreement with Comcast is not essential to viability. Let me be clear. Comcast carries a huge amount of independent programming. We want the best programming for our customers, no matter the source.

Mr. Chairman, the video marketplace looks nothing like it did in 1992. It's robust, dynamic, and irreversibly competitive. And rules intended for a very different time and place should be candidates for elimination, not expansion.

Thank you, sir.

[The prepared statement of Mr. Waz follows:]

PREPARED STATEMENT OF JOSEPH W. WAZ, JR., VICE PRESIDENT, EXTERNAL AFFAIRS AND PUBLIC POLICY COUNSEL, COMCAST CORPORATION

Chairman Stevens, Co-Chairman Inouye, and Members of the Committee, I appreciate the opportunity to appear before you today to discuss issues relating to video content.

Two years ago, the Federal Communications Commission (FCC) concluded that: "[T]he vast majority of Americans enjoy more choice, more programming and more services than any time in history."[1] Two years later, that statement can be made with even more conviction. It is undeniable that American consumers now enjoy access to an unprecedented array of video programming delivered in a growing number of ways by an ever-increasing number of competing providers. Comcast is one of those providers. And in every community that we serve, we are competing with DIRECTV, with DISH Network (EchoStar), often with companies like RCN, Knology and WideOpenWest (WOW), and any day now with companies like AT&T and Verizon.

This competition has driven our company, and the entire cable industry, to improve. But more importantly, it has given the American consumer the richest cornucopia of video programming in the world, with huge diversity of voices and content, meeting almost every conceivable need and interest.

[1] *In re Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming,* 10th Annual Report, 19 FCC Rcd. 1606 ¶ 4 (2004).

Competition in Distribution

When Congress and the FCC assess competition in video distribution, they have tended to confine their analysis to what they call the "multichannel video programming distributors," or "MVPDs." These include traditional cable television operators, "broadband service providers" like RCN, WOW and Knology, direct broadcast satellite (DBS) providers like DIRECTV and DISH Network, local exchange carriers like Verizon and AT&T, providers of Multichannel Multipoint Distribution Service, electric utilities, and satellite master antenna TV systems. Taken as a whole, the growth of these competitors has been extraordinary since Congress passed the Cable Television Consumer Protection and Competition Act of 1992 (1992 Cable Act). At that time, nearly 14 years ago, Congress foresaw the possibility of significant potential competition from these providers of multichannel video services, and it took measures to promote that competition. Today, that competition is real, robust, and thriving, as the most recent data from the FCC and other sources affirm.

The headline story is the extraordinary growth of DBS. DIRECTV and EchoStar each offer their services to almost every household in the United States, and they have captured over 27 million customers. Each year for the past five years, the DBS companies have added two to three million new customers, while the cable industry's basic subscribership has remained flat. Each of those two companies is now larger than every cable company in America except for Comcast.

The Bell Operating Companies are also making a large-scale entry into the multichannel video marketplace, and we believe they, too, will be formidable competitors.

Not every consumer chooses to take service from a MVPD, however. Anywhere from 15–20 million households prefer to rely on over-the-air television. And in several markets, local broadcast stations are banding together to create a multichannel over-the-air alternative offering dozens of cable networks to compete with cable and satellite. U.S. Digital Television is now operational in four cities (Albuquerque, Dallas, Salt Lake City, and Las Vegas), and for $19.95 per month provides its customers with 25–40 channels, including all the local broadcast stations (and their HD signals) and many of the most popular cable networks.

We think that the rapidly changing video marketplace compels Congress and the FCC to view "video competition" even more broadly. Today, tens of millions of Americans also supplement their viewing with DVD and videotape rentals and purchases, and Netflix has become a national phenomenon. In addition, an increasing number of Internet streaming and download options are emerging—witness the incredible explosion of services and devices at the Consumer Electronics Show earlier this month. From iPods to mobile phones to digital video recorders, everything is becoming a "video download" device.

The problem with television in America is not lack of choice—the problem is how a consumer can manage all of that choice!

In this unbelievably dynamic marketplace, neither Comcast nor anyone else can rest for even a moment. Each and every day, we compete to attract new customers and to keep our existing customers happy. This is why we have spent over $40 billion since 1996 to add the capacity to let us deliver 200 or more video channels to almost every home we pass . . . and added dozens of international and foreign-language channels . . . and added a dozen or more high-definition television (HDTV) channels in every market . . . and have become the industry leader in providing video-on-demand (VOD), offering our digital homes over 3,000 different programming choices any time, day or night, in every conceivable niche, including more local programming. We have to work hard to remain the first choice of our customers—and the way that we do that is by constantly investing in more capacity so that we can add new programming, new channels, and new features.

In short, the video distribution marketplace is more competitive and diverse than ever. As Congress looks to the future, it's wrong to view television as we viewed it in 1992—it's a fundamentally different medium, and it has become fundamentally and irrevocably competitive.

Competition in Content

The explosion of distribution outlets has launched a corresponding explosion in content. When the 1992 Cable Act was passed, there were approximately 68 national programming networks (and only a dozen or so regional networks) in operation in the U.S.[2] The majority of them were owned by cable companies (largely because independent programmers, the broadcast networks, and the Hollywood studios were not very interested in investing in cable programming at the time)—in fact, 57 percent of cable networks had "some ownership affiliation with the oper-

[2] H.R. Rep. No. 102–628, at 41 (1992) (noting that there were "68 nationally delivered cable video networks").

ating side of the cable industry."[3] The average household did not have cable at all, and those that did normally had access to about 36 analog channels of programming.

Fast forward to 2006—incredibly, there are over 388 full-time national programming networks in operation today, and nearly 100 regional networks as well. The number of "vertically integrated" channels has dropped to 23 percent, and Comcast has a financial interest in approximately seven percent of the networks that we carry. Eighty-five percent of all American TV households take service from a MVPD, and a typical MVPD household enjoys access to over 200 video channels. In addition, many producers—both majors and independents—are creating programming for video-on-demand, and some may use VOD exposure as a springboard for the creation of new full-time channels.

There are three important reasons for this proliferation of programming choices:

- First, the cable industry's dedication to invest over $100 billion to expand our distribution networks and tens of billions more to improve the quality and diversity of our programming offerings;
- Second, the emergence of DBS and other distribution media to provide additional outlets for programming;
- And third, the freedom that the law has given us to package and promote this programming in "tiers," and to create tiers and packages that respond to consumer demand, makes economic sense for our industry, and allows us to respond to competition from DBS and other providers.

To elaborate on the third point, it is important to note that having the freedom to create programming tiers and bundles lowers key costs and improves the economics of programming in ways that help to support those hundreds of channels. Program tiers lower transaction costs because it is easier, less confusing to customers, and less costly to cable operators to sell a bundle of services in a tier with a single transaction than to try to sell hundreds of different services on an a la carte basis. Tiers *reduce marketing costs* because program services sold in a tier do not have to spend as much to market the service (or to retain subscribers) as they would if customers were required to make (and could constantly change) individual purchase decisions for each service. Tiers *lower distribution costs* because the distribution cost per subscriber is the same regardless of the number of channels delivered, so the more channels subscribed to, the lower the average cost of distributing a channel. Tiers *increase the value of advertising* because they expand viewership by capturing occasional and spontaneous viewers. And tiers *reduce equipment costs* because the only way in which to deliver services sold a la carte is to require customers to purchase or lease addressable set-top boxes for every TV in their homes.

The benefits of tiering in this fashion are widely understood and appreciated by both network programmers and would-be programmers. That is why so many of them have so vigorously opposed calls to require distributors to sell programming a la carte. The fact that a la carte would result in consumers paying more for less has been recognized in virtually every informed analysis done to date, including studies by the FCC's Media Bureau, the Government Accountability Office, Bear Stearns, Boaz Allen, and Paul Kagan, among others.

Tiering and bundling of programming are entirely consistent with promoting both consumer choice and the economic viability of programming. Take Comcast's Arlington, Virginia system as an example. Our customers today can choose from over 1,000 program and price combinations to create a mix of services to meet any program interest or financial requirement:[4]

- *Limited Basic:* 32 channels, including all local broadcast stations, C–SPAN and C–SPAN2, News Channel 8, TV Guide, ABC Family, WGN Superstation, three Arlington Public School channels, a local government channel, and a leased access channel.
- *Expanded Basic:* 45 services, including CNN, ESPN, Discovery, Nickelodeon, Bravo, Food Network, Weather Channel, History Channel, and BET.
- *Premium Services:* services offered on a stand-alone basis, including HBO, Showtime, Cinemax, The Movie Channel, STARZ, ART (Arab Radio & Television), TV Asia, and Zee TV (an Indian-language channel).

[3] *Id.* (noting that "39 [of the 68], or 57 percent, have some ownership affiliation with the operating side of the cable industry").

[4] A customer must purchase Limited Basic in order to purchase any of the other packages listed here. This is because Congress prohibits cable operators from providing any tier of cable service to any customer who does not buy a tier that includes all local broadcast channels, as well as public, educational, and governmental channels. 47 U.S.C. § 543(b)(7).

- *Digital Classic:* an interactive programming guide, VOD access, 45 music channels, and 20 digital services, including Discovery Kids, Noggin, Fine Living, and Toon Disney.
- *Digital Plus:* Digital Classic services plus 23 additional digital services including National Geographic, three Discovery channels, Sundance, and 12 Encore channels.
- *Digital Silver:* Digital Classic services, Digital Plus services, and one premium service including the service's multiplexed channels and subscription VOD service.
- *Digital Gold:* Digital Classic services, Digital Plus services, and three premium networks including the services' multiplexed channels and subscription VOD services.
- *Digital Platinum:* Digital Classic services, Digital Plus services, and five premium services (HBO, Cinemax, Showtime, The Movie Channel, and STARZ) including the services' multiplexed channels and SVOD services.
- *Hispanic Tier—CableLatino:* An add-on package for any subscriber that has the Digital Classic or Digital Plus services. This package is comprised of 18 Hispanic language services, including Discovery en Espanol, CNN en Espanol, and Toon Disney Espanol.
- *Sports Tier:* An add-on package for any subscriber that has the Digital Classic or Digital Plus services. The Sports Tier is comprised of three out-of-market regional sports networks and Gol TV, NBA TV, and FOX Sports World.
- *HDTV Channels:* A package of 14 networks transmitted in HDTV, including ABC, NBC, CBS, FOX, WB Network, two PBS signals, iNHD, ESPN–HD, Comcast SportsNet–HD, HBO HD, Showtime HD, Cinemax HD, and START HD.[5]

Additional flexibility is provided by the ability to add premium channels and services in various combinations, our pay-per-view and VOD programming options, as well as the new Family Tier that we announced in December and will roll out company-wide over the next few months.

The Role of Regulation in the Licensing of Program Content

Policymakers have always understood that market forces are superior to government regulation in enhancing consumer welfare, and that is no less true in the area of video content.

Back in 1992, when DBS had yet to launch its first satellite and sign up its first customer, the cable industry faced little direct multichannel competition. In response to consumer complaints, and in the absence of meaningful alternative sources of programming, Congress passed strict regulations governing the cable industry. But even then, Congress expressed a strong preference for competition over regulation, and put significant emphasis on encouraging competitive entry.[6] In the years since, multichannel video competition has taken deep root, and today is irreversible. As a result, many of the regulations that currently govern the cable industry were intended to address less competitive market conditions that have long since changed.

Two of those regulations that are relevant to this hearing are the so-called "program access" provisions of the 1992 Act,[7] and the "program carriage" provisions of that Act.[8] The relevant provisions of the *program access* statute were intended to ensure that national satellite-delivered cable programming services in which cable operators had an attributable financial interest would be made available to the industry's competitors on rates, terms, and conditions comparable to those available to cable companies. The *program carriage* provisions were intended to ensure that, at a time when cable companies were perceived to be the sole providers of multichannel services, those companies could not play a "gatekeeper" role through actions that unfairly barred or conditioned distribution of independent programmers.

[5] Comcast does not charge separately for this programming but only for the HD-capable set-top box needed to receive it. With respect to premium services, customers receive only the HD versions of services they purchase.
[6] *See* 47 U.S.C. § 521(6).
[7] Cable Television Consumer Protection and Competition Act of 1992, § 12, Pub. L. No. 102–385, 106 Stat. 1460 (codified at 47 U.S.C. § 548).
[8] *Id.* § 19 (codified at 47 U.S.C. 536).

Program Access

The program access provisions, implemented into rules by the FCC,[9] ensured that fledgling DBS providers and other competitors would have access to programming perceived as critical to their success. These provisions represented a major departure from normal competition policy, which would encourage investment and innovation in exclusive programming. Exclusive programming permits competitors to distinguish themselves from one another. For example, DIRECTV has for several years had exclusive rights to the complete package of National Football League games, which has helped it to distinguish itself from both its cable and satellite competitors and contributed to the company's success.

In adopting program access requirements, Congress clearly did not intend to commoditize all video programming. The relevant provisions of the statute do not apply to any programming in which a cable operator does not have an attributable financial interest, nor does it apply to terrestrially distributed cable networks (of which there were more than a dozen in operation when the 1992 Act was passed). Nor does the statute require that all programming be sold to everyone or sold at the same price to all distributors. Thus, in adopting this striking exception to freedom of commerce, Congress specifically limited its marketplace intrusion, with full knowledge of what it was doing.

It can be said that the program access provisions have been a great success—though it would probably be more accurate to say that the marketplace is working. In the 14 years since Congress enacted these provisions, there have been far fewer program access complaints with the FCC than either the FCC or Congress envisioned (we estimate fewer than 50 in total), and almost none of these complaints has resulted in a ruling adverse to the programmer—in fact, most have been settled. Importantly, as competition has grown, the number of program access complaints has dwindled, not increased. What is clear in today's marketplace is that national programming networks, whether or not affiliated with a cable operator, desire broad distribution of their services and have every incentive to ensure that as many consumers as possible can see their programming, including the 27 million DBS subscribers and the customers of other MVPD competitors.

Perhaps the most frequently reiterated complaint under the program access rules concerns Comcast SportsNet (Philadelphia). The FCC (twice) and the courts (once) have thoroughly considered and rejected complaints by DIRECTV and EchoStar that Comcast's creation and distribution of this high-quality regional sports network violated the program access rules. All have concluded that Comcast was within its rights to make the economically sound decision to terrestrially distribute this network using a pre-existing terrestrial distribution system.[10] And while the DBS companies and others have cried wolf for nearly a decade, claiming that the FCC's decision would encourage companies to move their most valuable programming off of satellite (and therefore beyond the reach of the program access rules), the fact of the matter is that that has not happened. In fact, each of the four regional sports networks launched by Comcast since it created the Philadelphia network has been satellite-delivered, again for sound economic reasons.

DIRECTV and EchoStar both claim that Philadelphia professional sports programming is "must-have" programming and that they cannot compete in that region without it. The facts, however, do not support that claim.

Since the mid-1990s, nearly a hundred local Philadelphia professional sports events have been available on local broadcast stations, but the DBS companies did not carry these signals (which are available to them free of charge) until they were required to by Federal law. It is difficult to understand why, if this is "must-have" programming, they would not bother to carry it for free.

Moreover, based on the latest data from Media Business Corp. (as of 9/30/2005), it is clear that *DBS penetration in Philadelphia is higher than or comparable to that in many other urban markets.* Philadelphia has a DBS penetration of 12.04 percent—higher than Hartford (8.6 percent), Providence (9.39 percent), Springfield-Holyoke (8.65 percent), and Laredo, TX (7.92 percent); comparable to Boston (10.73 per-

[9] *See In re Implementation of Sections 12 and 19 of the Cable Television Consumer Protection and Competition Act of 1992: Development of Competition and Diversity in Video Programming Distribution and Carriage,* First Report & Order, 8 FCC Rcd. 3359 (1993).

[10] For reasons known only to RCN, that company has claimed for several years that it has not received access to Comcast SportsNet (Philadelphia) on reasonable terms and conditions. However, RCN has had the contractual right to carry Comcast SportsNet (Philadelphia) from the day it signed on the air, and RCN still has those rights today, on the same terms and conditions that Comcast and other cable companies carry the network. And in fact, RCN has carried the network on those terms since day one—even though Comcast is under no obligation to make it available.

cent), Las Vegas (10.96 percent), El Paso (11.01 percent), and Palm Springs (11.80 percent); and not significantly lower than New York (15.24 percent), Tampa (14.03 percent), Baltimore (14.15 percent), Milwaukee (15.08 percent), Norfolk (14.22 percent), or Harrisburg (13.29 percent), among others. And in fact, in the last five years, the DBS companies have *tripled* their market share in Philadelphia.

As I noted earlier, most programmers—including cable companies that own programming—want maximum distribution for most of their products. But that should not mean that cable companies, DBS companies, and others should not have the freedom to create and invest in some original and exclusive programming as well, in order to distinguish themselves from one another in the marketplace. In fact, Congress and the FCC should consider that the program access rules (and the corresponding restrictions that now apply to DIRECTV as a consequence of its merger with News Corp.) may now be having the perverse effect of reducing investment by the beneficiaries of these rules (including two of the three largest MVPDs in America, DIRECTV and EchoStar) in original programming—why invest and create when you can have access to someone else's work on the cheap?

Program Carriage

The program carriage rules were intended to be a guarantee against the ability of a cable operator, who 14 years ago might be presumed to have "monopoly gatekeeper" status, to bar or handicap independent programming networks from gaining distribution. These rules have almost never been invoked, again largely because the marketplace works. Anyone who has an attractive programming idea, a sensible business plan, and a willingness to negotiate carriage terms that make sense for both the programmer and the distributor, has had the opportunity to build a business.

In the past year, one company (Mid-Atlantic Sports Network, or "MASN") has filed a program carriage complaint, invoking these little-used provisions of law—the first such complaint ever filed against Comcast. A second company (The America Channel, or "TAC") has steadfastly refused to file a program carriage complaint, but it has attempted to leverage every other opportunity to get the government to force Comcast to carry it.

Let me address the MASN situation first. The Baltimore Orioles, as part of a deal with their affiliate, TCR, and Major League Baseball, created a new sports network (MASN) with the intention of carrying Baltimore Orioles games in 2007. And in an unprecedented move, Major League Baseball also granted to the Orioles organization control over the television rights of the new Washington Nationals baseball club. Comcast SportsNet (Washington/Baltimore) (CSN) has the television rights to Orioles games through the 2006 season, and it paid millions of dollars for the right to negotiate exclusively for renewal of those television rights and for the right to match any third-party offer received after that period of negotiation expired. For the Orioles' organization to agree to transfer to MASN the rights to Orioles games for annual license fees, and to declare that the Orioles games would be available only on MASN starting in 2007 without providing CSN the opportunity to match this deal, was a blatant breach of CSN's contractual rights. CSN is pursuing its rights in court. Meanwhile, TCR filed a complaint at the FCC alleging that Comcast's decision not to carry MASN violates the program carriage rules. Without detailing here the lack of merit of TCR's filings (we would gladly provide to the Committee upon request copies of relevant public documents filed at the FCC), it should be noted that some of TCR's allegations at the FCC were so frivolous and so outrageous that a consultant for Major League Baseball—which is the business partner of the Orioles—intervened on his own motion to denounce and refute those allegations.

Comcast wants to carry Orioles and Nationals games. But Comcast also wants to protect the contractual rights negotiated and paid for by CSN. We hope for a timely resolution that is in the best interest of our company, our customers, and the teams' fans.

Now let me briefly address the complaints by TAC. This is a would-be network that asserts that its inability to negotiate a carriage agreement with Comcast is an absolute bar to its viability. The fact is that TAC has done none of the things necessary to establish a viable network. It lacks a secure source of financing; it has not assembled any programming expertise; it has no coherent business plan; and—most importantly—it has created no programming. Not surprisingly, with a single exception, no established cable or DBS operator has entered into a carriage agreement with TAC.

TAC asserts that independent program networks cannot succeed without a carriage agreement from Comcast and Time Warner, and it claims that those companies will not work with independent program networks.

In response to the first point, I am attaching to my testimony a column by C. Michael Cooley of The Sportsman Channel, which appeared in the October 3, 2005 edition of Multichannel News, whose headline sums it up: "How I Started a Network Without Comcast." * Moreover, there are many networks that have become viable with no cable carriage, reinforcing the point that there are a sufficient number of U.S. MVPD households served by competitors to support such programming.

In response to the second point, marketplace facts refute TAC's assertion. Comcast carries scores of independent networks. In fact, it has no choice but to carry a significant number of independent programmers because customers demand it.

The fact of the matter is Comcast owns an attributable financial interest (which, for purposes of the FCC's rules, can be as little as five percent) in only about seven percent of the channels it carries. In other words, 13 out of every 14 channels carried by Comcast are owned by companies that are completely independent of Comcast. This should not come as a surprise—it is our goal, and a competitive necessity, to provide the best programming and the best value for our customers, regardless of who owns or produces the programming.

TAC lacks any basis for invoking the program carriage rules, which is the likeliest explanation for TAC's failure to file a complaint with the FCC. In the meantime, we have had continuing discussions with TAC over the past year, and we remain open to a meaningful dialogue. But it is important to remember that TAC is entirely in control of its own fate—and its failure to secure any meaningful carriage commitment from any of our established competitors suggests that the problem lies not with Comcast, but with TAC's business plan.

I anticipate that some parties at today's hearing may raise other complaints or allegations regarding the operation of the program access or program carriage rules, and I stand ready to provide information to the Committee that would respond to any such complaints.

Conclusion

Over the past 14 years, competition in the video marketplace has exploded. When the 1992 Cable Act passed, the majority of consumers had little choice from whom they purchased multichannel video service and comparatively limited programming choice. Today, almost every consumer in America can choose from among at least three MVPDs, each offering hundreds of programming services. And the number of viable programming alternatives aimed at the consumer market continues to increase with telephone company entry, innovations by terrestrial broadcasters, the emergence of the Internet as a viable video medium, and other distribution options.

The video marketplace is robust, dynamic, and hotly competitive. In light of the changes in both distribution and content creation over the past 14 years, this is the time for Congress to consider reducing, not expanding, regulation of video content. I urge this Committee to demand the facts from those on this panel who would argue otherwise, because the facts do not support their calls for regulation.

I thank the Committee for this opportunity to appear today.

The CHAIRMAN. The next witness is Dan Fawcett, Executive Vice President for programming of DIRECTV, in El Segundo, California.

Mr. FAWCETT. Thank you——

The CHAIRMAN. Sixty years ago, I would have been delivering your local newspaper.

Mr. FAWCETT. Oh, really? El Segundo?

The CHAIRMAN. Right.

STATEMENT OF DANIEL M. FAWCETT, EXECUTIVE VICE PRESIDENT, BUSINESS AND LEGAL AFFAIRS AND PROGRAMMING ACQUISITION, DIRECTV, INC.

Mr. FAWCETT. Chairman Stevens, Senator Dorgan, my name's Dan Fawcett, and I'm the Executive Vice President for Programming Acquisition at DIRECTV. Thank you for giving me the opportunity to be here today.

* The information referred to has been printed in the Appendix, page 73.

My testimony focuses on program access and the threat to video competition arising from the proposed Adelphia transaction.

Over the last decade, Congress has helped foster the competitive video marketplace that exists today. With DIRECTV leading the way, DBS has grown from fewer than 10 million subscribers in 1999 to more than 27 million today. Increased competition means consumers have more choices, customer service is more responsive, and innovation is flourishing. But these advances cannot be taken for granted. I am here to discuss how this progress is now being threatened.

Comcast and Time Warner, the Nation's two biggest cable companies intend to divide Adelphia's subscribers between them and to swap many of their current subscribers. The sole purpose of this transaction is to create concentrated regional monopolies across the country. If allowed to proceed without safeguards, Comcast and Time Warner will use this local dominance to deny competitors key regional programming, especially must-have local sports. And, in doing so, consumers will be harmed and fair competition will be impossible.

I know this, because I've seen it all before. My job at DIRECTV is to negotiate carriage deals with programmers, including regional sports networks. Over the years, I've seen how cable operators have managed to deny access to local sports programming in their effort to undermine competition.

Let me give you some examples:

Philadelphia is the poster child. The city is served almost exclusively by Comcast, which created an RSN with rights to the Phillies, Flyers, and 76ers. It then denied this network to Comcast competitors. For almost 10 years, satellite customers have had to give up the right to root for their home teams.

Just this year, in Charlotte, Time Warner secured a cable exclusive deal with the Charlotte Bobcats, meaning that, here, too, local fans face a grim choice, giving up watching the local team or give up the right to choose their video provider.

In Chicago, Comcast gained a regional monopoly by purchasing AT&T's cable systems in 2002. Comcast next purchased the rights of the Bulls, Blackhawks, Cubs, and White Sox, and launched its own sports network. Comcast made it available to DIRECTV, but at double the price DIRECTV had been paying to carry the exact same games.

Time Warner and Comcast are trying to follow the Chicago playbook for the new Mets channel. Both companies have an ownership interest in this channel and want DIRECTV to pay the astounding amount of over $17 million for one season of baseball or forego the games and give Time Warner and Comcast an exclusive.

In Ohio, where Time Warner will gain a regional monopoly from the Adelphia transaction, they are doing the same thing for the Cleveland Indians channel.

There is one constant in each of these scenarios: the cable operator obtains regional market power, which it then uses to secure local sports rights, which then enables it to use this must-have programming as a weapon against competitors. This is why the Adelphia transaction is so troubling. This deal will create regional monopolies all across America.

In Boston, Comcast will have over 75 percent of pay-TV subscribers, 70 percent in Pittsburgh, 67 percent in West Palm Beach. In Cleveland, Cincinnati, and Columbus, Time Warner's market share will be 60 percent or more. These high levels of concentration will allow Comcast and Time Warner to do the same thing in these cities that they have done in Philadelphia, Charlotte, and Chicago. Put simply, this plan puts at risk the more than 10 years of progress that Congress set in motion with the program-access statute.

To prevent this outcome, Congress can do two things:

First, we ask you to support DIRECTV's call for the FCC to narrowly condition the Adelphia transaction. In particular, the FCC should prohibit exclusive deals for RSNs in the regions where the Adelphia transaction will create market power. Distributors should also be permitted to seek an independent third-party review to ensure nondiscriminatory and fair pricing to competitors.

Second, we ask you to re-examine the program-access statute to, number one, close the terrestrial loophole; two, address discriminatory pricing schemes that circumvent the intent of the law; and, three, make the ban on exclusives permanent.

Cable operators were once the only game in town. As a result, prices were high, choices were limited, and customer service was legendarily bad. But at least in most places competition is now the order of the day, and the results are remarkable: unprecedented innovation, service improvements, more responsive pricing, and more choices than ever before.

On behalf of millions of Americans who benefit from the competition that we and others provide, we ask you to ensure a competitive video marketplace for the future.

Mr. Chairman, thank you for allowing me to present DIRECTV's views on these important matters, and I'd be happy to answer any questions.

[The prepared statement of Mr. Fawcett follows:]

PREPARED STATEMENT OF DANIEL M. FAWCETT, EXECUTIVE VICE PRESIDENT, BUSINESS AND LEGAL AFFAIRS AND PROGRAMMING ACQUISITION, DIRECTV, INC.

Chairman Stevens, Co-Chairman Inouye, and Members of the Committee, my name is Dan Fawcett and I am the Executive Vice President, Business and Legal Affairs and Programming Acquisition, at DIRECTV, Inc. Thank you for inviting me to testify today on video competition, program access, local sports programming, and the threats to competition arising from the proposed Adelphia transaction.

A key development in the American economy over the past twenty years has been the rise of a competitive video marketplace. Today, competition means consumers have more choices; customer service and pricing are becoming more responsive; technological innovation is flourishing, and tens of thousands of jobs have been created.

This is no accident. Rather, it is the direct result of public policies that promote competition. But today, this progress is being threatened.

Comcast and Time Warner, the Nation's two biggest cable companies, intend to divide Adelphia's subscribers between them and to swap many of their current subscribers. If allowed to do so, Comcast and Time Warner will control access to approximately 6 in 10 of the Nation's cable subscribers and almost half of all pay-TV subscribers. Of greater concern, the proposed transaction will create concentrated regional monopolies across the country where one of the two companies will become the single dominant video provider.

If allowed to establish such regional monopolies, without adequate safeguards, I can assure you that Comcast and Time Warner will deny key regional programming—especially local sports—to their competitors. Maybe they will do so directly, because the program access rules will not prevent them. Or maybe they will do so indirectly by increasing the price of this programming, which the program access rules also allow. Either way, tens of millions of consumers will be harmed, and fair competition will be impossible.

I know this because I've seen it all before. My job at DIRECTV is to negotiate carriage deals with programmers, including the regional sports networks (RSNs) that carry teams like the Indians and the Mets and the Red Wings in their hometowns. Over the years, I've seen how cable operators have managed to deny their competitors local sports programming in places like Philadelphia, where DIRECTV subscribers still cannot watch the Phillies, 76ers, and Flyers; and Chicago, where the price DIRECTV pays for sports programming has increased at exorbitant rates.

This should not be the model for the rest of the country. To prevent this, we have asked the FCC to place safeguards on the Adelphia transactions and we also urge Congress to update and strengthen the program access rules. Taken together, these regulatory and legislative recommendations will help to ensure that the competitive video marketplace that exists today will continue to flourish in the future.

I. Where Cable Operators Have Gained Sufficient Regional Concentration, They Have Withheld or Raised the Price of Key Local Sports Programming

Not so long ago, there was no such thing as video competition. If you wanted multichannel programming, your local cable operator was the only place to go. Over the past 15 years, however, sound public policy decisions by Congress have helped foster the rise of a truly competitive video marketplace. With DIRECTV taking the lead, DBS has grown from fewer than 10 million subscribers in 1999 to more than 26 million today—proof that when it comes to video, Americans want choice.

Thanks to this increased competition:

- DIRECTV and others have invested billions in new innovations.
- DIRECTV itself has invested billions to make local broadcast signals available to more than 93 percent of television households, and is investing billions more to create the capacity to provide 1,500 high definition local broadcast channels.
- Customer service and choice have improved throughout the video industry.
- Rural customers now have access to the latest products and services.

Because of the competitive marketplace this Committee helped create, *all* Americans—not just DIRECTV subscribers—are enjoying a better television experience.

But it almost never happened. Some Members of this Committee may remember that, when satellite first appeared on the scene, cable responded as any monopolist would—by trying to protect its monopoly. One strategy was to deny key programming to its satellite rivals.[1] Cable hoped that, if it could prevent satellite from carrying the most desirable programming services, it could strangle competition in its infancy. So cable operators refused to sell programming they controlled to satellite and used their market power to secure exclusive contracts with key unaffiliated programmers.

But to cable's chagrin, Congress stepped in. In 1992, Congress created program access requirements designed to prevent such abuses of market power. Under these rules, cable operators were prohibited from negotiating exclusive or "sweetheart" deals for cable-affiliated programming. The idea was that, with a level competitive field, new entrants such as DIRECTV could compete on the merits of their offerings, and consumers would benefit from their efforts to win customers from each other. The rules have been an unmitigated success: without them, satellite television would never have gotten off the ground.

In recent years, however, cable operators have devised increasingly sophisticated ways around Congress's pro-competitive rules. The program access rules no longer provide any real barrier to cable giants such as Comcast and Time Warner. Thus, we now find ourselves in much the same situation as before Congress enacted the program access rules—in regions where a cable operator possesses market power, it will deny or raise the price of key programming to its competitors. In particular, cable will seek to withhold the kind of local sports programming that the FCC has determined to be "must-have" for distributors.

Let me give you some examples:

[1] This, of course, wasn't the only strategy employed by cable to retain its monopoly. Some Members of this Committee might remember "Primestar," the cable industry's attempt to launch its own satellite service as a "stalking horse" to block competitive DBS entry—in part by obtaining scarce DBS licenses. In the end, the Department of Justice and 45 states sued Pnmestar and obtained a consent decree curbing the most obviously anticompetitive tactics.

A. Pure Withholding of Affiliated RSN—Comcast in Philadelphia

The poster child of local sports withholding is, of course, Philadelphia. Because Philadelphia is Comcast's hometown, Philadelphia was one of the first "clustered" markets. While some metropolitan areas are served by many different cable operators, Philadelphia is served almost exclusively by Comcast. Armed with such regional market power, Comcast created "Comcast SportsNet"—an RSN with rights to the Philadelphia Phillies, Flyers, and 76ers. It then decided not to make this network available to Comcast's competitors. [2]

It was able to do this because of what has since come to be known as the "terrestrial loophole." The program access rules only apply to programming delivered to cable systems *by satellite.* [3] Because it delivers Comcast SportsNet to its cable systems via fiber, Comcast argues that Comcast SportsNet is not subject to the program access rules and need not be made available to customers of their competitors.

DIRECTV has always thought this was, at best, an evasion of the 1992 Cable Act. But the FCC (and, later, the DC Circuit) concluded that a plain reading of the statute's reference to "satellite programming" allows Comcast to freeze out its competitors in Philadelphia. And this is exactly what Comcast has done. To this day, fans of the Phillies, 76ers, and Flyers must either give up the right to root for their home teams or give up their right to subscribe to the video provider of their choosing. Is it any wonder that satellite's market share in Philadelphia is less than half of what it is nationally?

B. Pure Withholding of Unaffiliated RSN—Time Warner in Charlotte

Comcast found it easy to deny satellite subscribers local sports programming in Philadelphia because it owned the RSN in that market. But cable doesn't need to own a sports channel in order to deny it to satellite subscribers—just ask DIRECTV subscribers in Charlotte.

In Charlotte, Time Warner controls a regional monopoly similar to that enjoyed by Comcast in Philadelphia. In fact, Time Warner controls so many subscribers in Charlotte that, when Carolina Sports and Entertainment Television ("C–SET") launched last season with rights to the NBA's Charlotte Bobcats, Time Warner was able to establish an exclusive deal to carry the team's games. Because C–SET was not affiliated with a cable operator, the program access rules did not prohibit this exclusive deal. Since then, C–SET has gone out of business. But just a few months ago, Time Warner secured yet another deal with the Bobcats (this time without C–SET). And the Bobcats are still not available to satellite. And so here too, as in Philadelphia, local fans face the same grim choice: give up watching the team, or give up the right to choose video providers.

C. Uniform Price Increases—Comcast in Chicago

Cable operators have found that refusing to sell local sports programming to competitors, although effective in boosting market share, is a fairly blunt tool. Savvy cable operators have thus resorted to more subtle—but equally anticompetitive—tactics.

Take Chicago, for example. In 2002, Comcast purchased AT&T, and in the process established a regional monopoly in Chicago similar to its dominance of Philadelphia (and similar to the level of concentration that the Adelphia acquisition could create in markets across the country). Comcast next purchased the rights to the Bulls, Blackhawks, Cubs and White Sox and launched its own sports network, CSN Chicago. When DIRECTV sought carriage of this critical programming, Comcast made it available to DIRECTV—but at double the price DIRECTV had been paying to carry these same games. Unwilling to forgo this must-have programming, DIRECTV had no choice but to accede to Comcast's demands.

The program access rules do not prohibit this kind of behavior so long as Comcast pays the same high price. But that restriction is of no concern to Comcast because even inflated payments are simply a transfer of money from one division of Comcast Corporation to another.

[2] In 2002, the last time Comcast had a big merger pending, it was persuaded to make Comcast SportsNet available to cable overbuilders such as RCN. But it has never made this programming available to satellite.

[3] When Congress was drafting the program access provisions in 1992, it wanted to allow exclusive deals for local cable news channels. The idea was that, if a cable system spends a lot of money creating a local cable news channel, it shouldn't have to make that channel available to its competitors. At the time, local cable news was primarily delivered to cable offices over telephone wires. Other programming (such as ESPN, CNN, etc.) was delivered to cable offices via satellite. So Congress decided to restrict exclusive contracts only for "*satellite* cable programming" (that is, "video programming which is transmitted via satellite").

Comcast thus has every incentive to jack up the price of CSN-Chicago (and similar RSNs) in the future. If DIRECTV doesn't pay the higher prices, Comcast gets a *de facto* exclusive for the channel. If on the other hand DIRECTV pays the artificially high price, Comcast extracts a supra-competitive rate and drives up DIRECTV's costs. This, in turn, makes it more difficult for DIRECTV to compete with Comcast on price. Either way, Comcast wins—and consumers lose.

D. "Stealth Discrimination" of Affiliated RSN—Comcast in Sacramento

Sometimes, a cable operator with a regional monopoly doesn't even need to "officially" raise RSN prices in order to distort competition. In Sacramento and San Francisco, as in Chicago, Comcast was able to establish a regional monopoly when it purchased AT&T's cable systems. And, as in Chicago, it went out and created its own Sacramento RSN, CSN West, with rights to only one professional team, the Sacramento Kings.

In my experience, RSNs only offer their programming in the territory established for the team by its league. But this is not the case for CSN West. Comcast has mandated a service area for CSN West much larger than the area in which the NBA permits CSN-West to carry Kings games. Under Comcast's pricing scheme, however, DIRECTV must pay for subscribers to whom it can't even show the Kings games. In fact, DIRECTV pays for more subscribers who cannot watch the games than those who can. These customers account for one-third of the total license fees paid for the network. Cable operators, with much smaller service areas, do not face this dilemma.

E. The Trend Continues . . .

One might think that, with a gigantic merger pending before the FCC and the FTC, Comcast and Time Warner might at least slow down their effort to undermine competition through the acquisition and withholding of sports programming. But even the threat of government oversight does not appear to faze them.

Time Warner stands to gain enormous market share in Ohio through the Adelphia transactions. So it recently announced that it will help launch a new RSN to carry Cleveland Indians games. Following the playbook used by Comcast in Chicago, Time Warner has proposed a rate for this single-team, part-time channel that is almost 90 percent of what DIRECTV was paying for *four* teams: the Indians, Cavaliers, Reds and Blue Jackets.

Time Warner and Comcast are trying to do the same thing in New York, where they control many subscribers. Both have an ownership interest in SportsNet New York, the new Mets channel. SportsNet New York wants to charge DIRECTV a higher price than it pays on a per game/per subscriber basis for the YES network—which carries the Yankees. This is an astronomical rate, particularly considering the fact that the ratings for the Mets games on FOX Sports New York/MSG have historically been less than *half* the ratings for the Yankees games on YES.

Again, Comcast and Time Warner have nothing to lose by this behavior. They can set "nondiscriminatory" high prices, knowing that they will recoup the cost through their ownership interest in the RSN. If DIRECTV refuses to go along, DIRECTV subscribers will lose Indians and Mets games. For Clevelanders and New Yorkers who want to watch their local teams, DIRECTV will not be an option, to the delight of Comcast and Time Warner. If, on the other hand, DIRECTV pays the inflated price, our costs go up. Again, Comcast and Time Warner win, and consumers lose.

II. The Adelphia Transactions Will Make This Behavior Possible in Many More Markets

There is one constant in each of the scenarios I've just described to you. In Philadelphia and Charlotte and Chicago and Sacramento, a single cable operator enjoys a very high market share. Thus, Comcast could only withhold Philadelphia sports programming because it controls a regional monopoly in Philadelphia. And it could only raise the price of sports programming in Chicago after it gained a regional monopoly there in 2002. This is for a simple reason—as a cable operator controls more subscribers in a particular area, an RSN operating in that area gains more from distribution on the cable system and *loses less* if it denies distribution to the cable operator's rivals.

This is why the proposed Adelphia transactions are so dangerous. Comcast and Time Warner propose to split up Adelphia's systems, and swap systems among themselves, for the stated purpose of increasing regional concentration. Indeed, they are *selling* this merger both to Wall Street and to regulators as one that will increase what they call "geographic rationalization."

One way to measure the extent of concentration that will result from this merger is through a tool called the Herfindahl-Hirschman Index (HHI), a widely used and accepted measure of market concentration. Under the Department of Justice Merger

Guidelines, a merger resulting in an HHI greater than 1800 and a change of more than 100 is presumed to create market power. As described in the table below, the HHI's resulting from this transaction would dwarf those thresholds in the pay-TV markets in many RSN service areas.

RSN	HHI	HHI Change
C–SET	4,210.6	403.7
Comcast SportsNet Philadelphia	4,156.7	376.9
FSN Florida	2,529.2	580.7
Sun Sports	2,515.2	578.0
FSN Ohio	2,395.7	837.8
FSN West/West 2	2,216.9	740.5
Mid-Atlantic Sports Network	2,168.7	358.6
Comcast/Charter Sports Southeast	2,148.6	325.8
Comcast SportsNet MidAtlantic	2,126.4	390.8
FSN Pittsburgh	2,080.1	576.9

In terms of market share, this means that Comcast will have over 75 percent of pay-TV subscribers in the Boston DMA, 70 percent in Pittsburgh, and 67 percent in West Palm Beach. Time Warner's share in Los Angeles will go from 9 percent to 48 percent and in the Cleveland, Cincinnati and Columbus pay-TV markets, Time Warner's market share will be 60 percent or more.

Think about what this means. In markets such as Philadelphia, Chicago, and Charlotte where Comcast and Time Warner already have regional monopolies, they have withheld sports programming from competitors or raised its price to competitors. With the Adelphia transaction, Comcast and Time Warner seek to create the conditions that would allow them to do the exact same thing in Boston and Pittsburgh and Cleveland and Los Angeles and West Palm Beach. Which means fans of the Red Sox , the Pirates, the Indians, the Cavaliers, the Dodgers, and the Clippers could all find themselves over a barrel—forced to either give up the right to watch their home town teams or give up the right to choose video providers. With the number of markets affected by the Adelphia transaction, this threatens the progress Congress set in motion over a decade ago.

III. The FCC Should Impose Conditions on the Adelphia Transactions

If Comcast and Time Warner are successful in their plans, we could be looking at a return to the "bad old days" of cable monopoly. DIRECTV has thus asked the FCC to impose narrowly-tailored conditions on the proposed Adelphia transactions. These recommendations closely mirror the conditions imposed by the FCC in the News Corporation/DIRECTV merger.

First, the FCC should prohibit exclusive deals (including "cable only" exclusives) for RSNs, regardless of delivery mechanism or affiliation, in the regions where the Adelphia transaction will create market power. This will prevent Comcast and Time Warner from taking advantage of the "terrestrial loophole" (as Comcast has done in Philadelphia). It will also prevent Comcast and Time Warner from entering into exclusive deals with unaffiliated RSNs in highly concentrated markets (as Time Warner has done in Charlotte).

Second, the FCC should prevent "price discrimination" by permitting distributors to seek arbitration when negotiations break down. This would simply allow a competitor to seek an independent third party review to ensure nondiscriminatory and fair pricing to competitors. An integral component of this recommendation is that competitors must be permitted to continue providing this "must-have" programming to consumers while any arbitration is pending.

These conditions are not exceptional in the video service industry. In fact, the FCC has consistently noted that the rise of regional monopolies poses a threat to competition and that it is appropriate to exercise regulatory authority to prevent such monopolies from exercising their market power to the detriment of competition.

Only through these narrow conditions can the FCC address the very real anti-competitive consequences of the merger that I have described to you. I would thus ask this Committee to urge the FCC to approve this transaction only with these or similar safeguards.

IV. Congress Should Re-Examine the Program Access Rules

For those concerned about competition in the video market, the Adelphia transactions are plainly the immediate priority. In the longer term, however, Congress should consider re-examining the program access rules. In particular, it should close the terrestrial loophole and ensure that the rules apply to the other forms of discrimination I have described.

As discussed above, the terrestrial loophole allows cable operators to deny programming from their competitors so long as the programming is not delivered to the cable systems. The rationale for this was to encourage cable operators to develop their own local news channels. The exception certainly was never intended to apply to local sports programming, which was delivered at the time via satellite. There is, moreover, simply no need for Congress to encourage the creation of local sports programming. Such programming, as the FCC has determined on several occasions, is among the most valuable on television. It also cannot be "created" through Congressional encouragement—each team is unique, and games involving that team cannot be duplicated in the way that, for example, local news can.

When it created the program access rules, Congress surely never expected regional sports programming to be subject to exclusive deals. Congress should remedy this by closing the terrestrial loophole (at least as for RSNs), and make it clear that the full panoply of the program access restrictions in the 1992 Cable Act apply to RSNs, however they may be delivered to cable systems.

When it examines the program access rules, moreover, Congress should also consider how to address the other sorts of anticompetitive activities that I have described, but that the existing rules appear not to reach. There is simply no reason why cable operators should be allowed to engage in the kind of behavior exhibited by Comcast in Chicago and Sacramento. It should also ensure that the program access rules will continue to apply beyond their current expiration date.

Cable operators were once the only game in town. As a result, prices were high, choices were limited, customer service was legendarily bad. But, at least in most places, competition is now the order of the day and the results are remarkable: unprecedented innovation, service improvements, more responsive pricing and more choices than ever before.

But all that has been gained could yet be lost. If allowed to proceed with the Adelphia transaction without adequate safeguards, Comcast and Time Warner will have both the incentive and the ability to undermine competition in market after market throughout the country. This will undo the progress Congress set in motion with the program access rules over ten years ago. On behalf of the tens of millions of consumers who want continued access to their local teams at reasonable prices, I ask you not to let that happen.

Chairman Stevens, Co-Chairman Inouye, and Members of the Committee, thank you for allowing me to present DIRECTV's views on these important matters. I would be happy to take your questions.

The CHAIRMAN. Thank you very much.

Our last witness is Doron Gorshein, Chief Executive Officer and President, The America Channel, of Heathrow, Florida.

Press the button.

Mr. GORSHEIN. Are we on? OK.

The CHAIRMAN. I wasn't on. Now I'm on. We're going to get one automated one of these years.

Mr. GORSHEIN. It works.

STATEMENT OF DORON GORSHEIN, CHIEF EXECUTIVE OFFICER/PRESIDENT, THE AMERICA CHANNEL, LLC

Mr. GORSHEIN. Mr. Chairman, Members of the Committee, thank you for the opportunity to testify.

The America Channel is a new nonfiction programming network set to launch later this year. It will explore and celebrate America, profiling its diverse communities, local heroes, and ordinary people who accomplish the extraordinary.

The America Channel was founded after 9/11, when television no longer resonated with my sensibilities as an American consumer. Indeed, our stellar market research and consumer and system feedback confirmed that Americans want more relevant programming about what makes America special, more community, more connectivity, more authenticity on television. We believe that The

America Channel could be the most resonant new product to come along in quite some time.

In recent months, we've secured distribution with no less than six telcos, close to 90 percent of the projected telco video space, including Verizon, AT&T, and others. Channels that have 90 percent of the cable space have been around for 25 years. In telco, we did it in 5 months.

In contrast to our success in telco, after close to 3 years we've had virtually no progress getting carriage from the dominant cable operators. Without distribution on the largest cable operators in key markets controlled by them, a channel is not viable. Of the 92 channels that have reached the critical viability threshold of 20 million homes, not a single one did so without at least two of Comcast, Time Warner, and Adelphia; 91 out of the 92 got both Comcast and Time Warner. John Malone said that an independent channel has no chance whatsoever if Comcast doesn't carry it.

We found that each of the top two cable operators, over a two-and-a-half-year period carried on a nonpremium, national basis, only 1 out of 114 channels with no affiliation—no media affiliation. And that's less than 1 percent. The single one that got carriage is the one referred to in Comcast's submission. In contrast, most of the channels affiliated with a cable or broadcast company got carriage on one or both of the top cable operators. Comcast carries 100 percent of its own channels, and almost all of them, if not all of them, on analog. Affiliated channels are also typically given 11 times the number of homes, on a median basis.

A number of studies, including one by the GAO, confirmed that the top cable operators are much more likely to carry their own channels than independent channels. Such disparities cannot be explained on the basis of free-market considerations alone. Affiliation is a major factor.

Why are independent channels locked out by cable? Because independent channels are direct competitors to cable-affiliated channels on several fronts—for viewers, ad dollars, technical capacity—and the asset value is independently owned. Independent channels apply downward pricing pressure on affiliated channels. Cable-affiliated channels, on average, cost more than three times the cost of an independent. One top cable operator derives 40 percent of its operating income from its television networks. That operator has strong incentive to exclude less expensive and better products to protect increased rates for its own channels.

A fully distributed channel is typically valued in the billions of dollars and generates annual revenue in the hundreds of millions. Cable operators want to own that. So, there's an inherent conflict of interest that prevents the best and cheapest products from entering the market.

The results? Cable rates have doubled in 10 years. Only one other consumable has matched this: gasoline. Other telecom services have all gone down—telephone, wireless, long distance, broadband. If better and cheaper content competitors are kept out of the market, consumer prices will rise, and there will be adverse effects on consumer choice, competition, diversity, and decency.

What are the solutions? On the distribution side, nothing could be more important than expeditious enactment of telco video franchise relief. Telcos must be allowed to compete in local markets. And competitors, like DIRECTV, EchoStar, and RCN, should have the same fair access to sports nets and other must-have programming.

The other half of the problem is on the content side. The stifling of competition and abuse of gatekeeping power requires urgent action. One solution is for the FCC to impose conditions on the Adelphia merger, as we and others have urged them to do.

Congress might consider other solutions. For example, going forward, 50 percent of all new channel capacity on Comcast and Time Warner should be designated for independent networks with no cable or broadcast affiliation. After all, Comcast and Time Warner have indicated that capacity will increase if they are permitted to acquire Adelphia.

Section 25 of the Cable Act of 1992 provides sound precedent. There, Congress took steps to ensure access for a valuable type of programming that had difficulty reaching the public.

Certainly, there are other creative solutions. We look forward to working with you to craft fair remedies for all, most importantly to the public. Foreclosure of opportunities for independent channels is a detriment to competition, consumer choice, consumer pricing, diversity of information sources, decency, and the national discourse. We must have a free-market environment which permits new market entrants to compete on their substantial merits. It is my hope that we can address these systemic problems that play out to the detriment of all Americans.

Thank you, again, for the opportunity to testify.

[The prepared statement of Mr. Gorshein follows:]

PREPARED STATEMENT OF DORON GORSHEIN, CHIEF EXECUTIVE OFFICER/PRESIDENT, THE AMERICA CHANNEL, LLC

Overview

The stifling of competition in the content space has led to cable rates which have increased 60 percent in 5 years, and doubled in 10 years. Only one other consumable has matched this dismal record. Virtually every other service to the home—for which there is competition—has stayed the same or gone down, including broadband, dial-up, long distance, wireless, etc.

In contravention of the clear intent of Congress and the FCC, Comcast and Time Warner have become unreasonable gatekeepers with the ability, and the incentive, to prevent competitive independent products from reaching key thresholds of viability. This power will be enhanced and consolidated by the proposed Adelphia transactions.

Existing FCC carriage laws, which prohibit discrimination against channels on the basis of affiliation, have to our knowledge never been formally enforced in 13 years since their enactment. Horizontal and vertical ownership limits, mandated by Congress to protect the industry and the public from the harms that would result in unchecked consolidation, have proven ineffective—in part because of the severe concentration of Comcast and Time Warner systems on a regional basis in 23 of the top 25 markets.

The evidence shows that, as a result of their size and dominance of the top television markets, Comcast and Time Warner's market power is severe and vastly exceeds their national market share. Carriage by both is required for any ad-supported network to survive.

The major telcos are embracing video competition and have agreed to carry The America Channel and other independently owned channels. Unlike the telcos, the top cable operators are vertically integrated—they own channels. Thus, independent channels are *direct competitors* to cable-affiliated channels on several fronts—for viewers, ad dollars, technical capacity, and the asset value which is independently owned. New independent channels also create downward pricing pressure on affiliated channels. The availability of independent channels promotes competition, better consumer pricing, greater consumer choice, and improves the diversity of ideas and the national discourse.

The record shows that the top cable operators have prevented independent channels from competing, in favor of networks owned by cable or broadcast conglomerates. This clear record of exclusion, along with the top cable operators' power and economic incentive to stifle competition, combine to create a "perfect storm" against independent channels. The Adelphia transactions may lead to the permanent end of new independent channels.

At stake is the health of competition, consumer pricing, consumer choice, the diversity of ideas in the marketplace, and the quality of the national discourse, all of which are damaged by the foreclosure of opportunities for independent programming networks.

1. Severe Market Power in the Cable Marketplace—Two Gatekeepers Control Channel Entry and Survival

"Basically, the consolidation of the business has got to the point where I don't believe that an independent programmer has any chance whatsoever of doing anything unless he's heavily invested in and supported by one of the major distributors . . . There's no way on earth that you can be successful in the U.S. distributing a channel that Brian Roberts (of Comcast) doesn't carry, particularly if he has one that competes with it."—John Malone, CEO of Liberty Media.

Despite Congress and the FCC's clear intent to prevent such consolidated market power, and to the detriment of competition, consumer pricing, consumer choice, the diversity of ideas in the marketplace and the quality of the national discourse, two cable companies currently stand as gatekeepers to network viability. Time Warner and Comcast already exercise extreme influence over the health of competition in the marketplace, influence which far exceeds their market share. The proposed Adelphia transactions will only exacerbate this situation.

A. Control of Subscriber Thresholds

Revenue for any advertising-supported network is dependent primarily on distribution, both to a sufficient number of households and to the top television markets. As such there are certain "viability factors" which must be achieved in order for a network to survive. The first is to acquire (at a minimum) carriage into *20 to 25 million homes*, at which point the network may be able to acquire a rating by Nielsen Media Research. The second threshold is to increase carriage to *50 million homes* because, as many media companies have stated on the record, most national advertisers view 50 million homes as a minimum distribution base—networks with subscriber counts below this level will receive substantially smaller allocation of these advertisers' funds, or not be considered at all.

The inability of an advertising supported network to compete for national advertising dollars severely impacts the long-term survivability of a network. The *New York Times* on July 25, 2005 reported the following: "Generally, the threshold of success for aspiring cable or satellite channels is about 50 million homes, said Tom Wolzien, a media analyst . . ." [1] A&E Television Networks (owner of at least 5 ad supported networks) filed comments at the FCC which put the long-term viability threshold even higher, stating "In order to attract sufficient advertising revenue to afford to pay for and provide a meaningful quantity of original programming, the network must reach approximately *sixty* million subscribers." [2]

Reaching 50 million subscribers without carriage by Comcast and Time Warner is virtually impossible, even today, and requires carriage by nearly every single other cable provider and on each provider's most widely distributed platform (i.e. analog basic). In addition, empirical evidence demonstrates that carriage by both Comcast and Time Warner is required for a cable channel to reach even half that amount—25 million subscribers.

Looking at the 92 cable channels which we found to have reached the first viability threshold of 20 million subscribers (required for Nielsen ratings): [3]

- Only 3 of the top 50 cable channels are independent—they have no ties to a cable operator or broadcaster.
- Only 9 of the top 92 cable channels have no ties to a cable operator or broadcaster.

[1] *New York Times.* 07–25–2005. *For Gore a Reincarnation on the Other Side of the Camera.*
[2] MB Docket 04–207, Comments of A&E Television Networks

[3] Two CSPAN networks are distributed to more than 20 million households. Because of the unique nature of CSPAN, we did not count these networks as either affiliated or independent.

- 91 of the top 92 channels secured carriage from both Comcast and Time Warner.
- 1 of the top 92 secured carriage from only one of Comcast or Time Warner—but it also secured carriage from Adelphia.
- *Not a single channel* was able to reach even the critical first viability milestone of 20 million homes, without 2 of the 3 transacting parties. After the Adelphia transaction, it will therefore be empirically impossible for an independent channel to be viable without both of Comcast and Time Warner.

That carriage by both Comcast and Time Warner is required for a network to surpass even 25 million households, *overrides a strict market share analysis*. Kagan Research estimates that there are approximately 92.6 million multichannel households in the United States.[4] According to their joint filing for the Proposed Transactions (MB Docket 05–192), there are nearly 70 million households which Comcast does not serve and there are 53.4 million subscribers which neither Comcast nor Time Warner serve. Therefore, theoretically a sizeable "open field" exists from which cable programming networks should be able to reach these minimum distribution thresholds without carriage by Comcast or Time Warner. *The fact is, however, that it has not happened*. Comcast and Time Warner's market power exceeds their large market share. This aggregation of market power is due, in part, to their regional dominance of top television markets.

B. Importance of Top Markets in Market Power

Raw subscriber numbers alone do not guarantee network viability. In order to compete effectively for advertising dollars, networks must also be carried in the *top television markets*. There are 210 Designated Market Areas (DMAs) in the U.S., but nearly 50 percent of all television households reside in the top 25 DMAs. An advertising supported cable channel which is unable to reach these households is at an extreme disadvantage in the battle for national advertising dollars. Similarly, a new advertising supported cable channel which cannot project carriage over time to these top markets may not be able to forecast the profitability needed to generate investment and enter the marketplace as a competitor.

As a result of the Adelphia transactions,

- Comcast and Time Warner will serve customers in 23 of the top 25 DMAs and 38 of the top 40 DMAs. Comcast or Time Warner will serve an average of 50.3 percent of the multichannel homes in each of these 23 DMAs.
- Comcast and Time Warner will serve more than 50 percent of all multichannel households in at least 12 and perhaps as many as 16 of the top 25 DMAs as well as a majority of households in Manhattan.
- 13 of the top 25 DMAs will see an increase in the percentage of subscribers controlled by a single MSO. (This does *not* include the several DMAs which will see change in system ownership but not an increased consolidation, such as Dallas.)

Further, it is important to note that this regional dominance in top markets is something which *is not replicated by DBS providers* who may have substantial subscriber totals, but as a result of their national dispersion do not share Comcast's and Time Warner's apparent pocket monopolies and gate-keeping ability with respect to top markets. In fact, DBS penetration in the top 25 DMAs is 18 percent *lower* than the national average.[5] Across the U.S., DBS has just over 23 percent of television households. In the top 25 DMAs, DBS's share is only 19.3 percent. Therefore, carriage by both DBS providers on their most widely distributed packages would at best enable a cable channel to reach one-fifth of the households in the top markets.

That the top 25 markets contain nearly 50 percent of all television households makes them undeniably important to any advertiser. However, research shows that these markets are *disproportionately valued* by advertisers—that advertisers put more resources toward reaching a viewer in a top television market than they do toward reaching the average television viewer. Consequently, foreclosure of those markets by Comcast and Time Warner is even more damaging to an advertising supported network than the numbers would imply.

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[4] Kagan Media Money. April 26, 2005 at 7. Multichannel households is herein defined as any household which receives television programming from an MVPD.

[5] Data source: the television advertising bureau, *www.tvb.org*. Note: TVB's analysis grouped DBS with other "alternate delivery sources," which include Large Dish satellite, satellite master antenna systems (SMATV), and multipoint distribution systems (MDS).

This preference of advertisers for top markets was proven by researchers from Consumers Union and Consumer Federation of America, who looked at the relationship between the share of television households in a DMA and the share of overall television advertising dollars spent on that DMA.[6] Among other things, their independent analysis revealed:

- Television advertisers spend 20 percent more to reach each household in the top 25 markets than they do the average U.S. household. The top 25 DMAs were found to have 49 percent of television households yet receive 59 percent of the TV ad revenue.
- Television advertisers spend 32 percent more to reach each household in the top 11 markets than they do the average U.S. household. (The top 11 DMAs are *all* served by the transacting parties.) The top 11 DMAs contain roughly 31 percent of the television households but receive 41 percent of the TV advertising revenue.

What Drives the Disproportionate Value Placed on Top Markets?

Factors which we confirmed with advertising industry veterans, which contribute to the preference of advertisers for the top television markets, include: *population density* (which provides the opportunity for greater numbers of people to see the spots, see the products in use, and for word of mouth to spread), *the density of retail outlets* (urban areas give viewers significantly more opportunities to act on the advertising messages they see), *younger populations* (18 to 34 is the age bracket most desired by advertisers, and this age bracket tends to live in the urban areas which comprise the top markets), *disposable income* (the average household in a Top 10 DMA has 19 percent more disposable income than the national average; the average household in a Top 25 DMA has 8 percent more disposable income than the national average), and *product adoption patterns and the presence of major press* (national trends are set in large urban areas, where population density contributes to rapid word of mouth exposure, and national press outlets can accelerate a product into the mainstream).

Foreclosure from the top markets can also hinder a network's survival by materially impacting its ability to be reliably rated by Nielsen. The majority of Nielsen's National People Meters (which collect ratings data) are located in the top DMAs.[7] Networks that are not available in these markets have a smaller population of meters from which to derive the statistically significant data upon which media buyers rely, and may not meet Nielsen's reporting standards.

C. Impact of Market Power

As discussed in the above sections, Comcast and Time Warner, because of their size and dominance of top television markets, wield unreasonable power over network survival. A national cable network that is denied carriage by Time Warner and Comcast cannot be economically viable in the long term. Therefore, the denial of carriage by these two market leaders signals to the market that a channel is unlikely to survive, and hence has a preclusive effect on the ability and willingness of other cable operators to embrace a channel. The majority of smaller operators are hesitant to dedicate the channel capacity, marketing and other resources necessary to distribute a product from a programmer whose survivability is uncertain. Gary Lauder, who runs Lauder Partners, a VC firm with a long track record in cable investment, stated recently, "Sure, there are other big MSOs and plenty of small or midsize operators VCs could approach with a promising enterprise. *The problem is, so many of the other MSOs wait until [they see] what Comcast or Time Warner does. So that creates a problem.*"[8]

Others from the venture capital community share this assessment of Comcast and Time Warner's market power. Richard Bilotti, the respected cable analyst for Morgan Stanley recently stated, "*Without distribution from Comcast, it would be virtually impossible for any network to be profitable.*"[9] And an April CableWorld article reported on the Venture Capital community's hesitation to fund cable startups, stating "VCs are holding back. Their number one hurdle: *Any cable-related venture that*

[6] MB Docket 05–192, Reply comments of Consumers Union, Consumer Federation of America at 22–23.

[7] Nielsen's National People Meters are dispersed according to Census data. DMA ranking is done by the number of television households. There is a positive but not perfect correlation between the percentage of total U.S. television households in a DMA and the percentage of national people meters located therein.

[8] CableWorld. April 4, 2005. "How Come the Vultures Don't Flock to Cable?" by Simon Applebaum.

[9] Source: "Is Comcast Too Big?" *Broadcasting and Cable*, July 25, 2005.

seeks funding must have a deal in place with Comcast or Time Warner Cable. If one or both multi-system operators isn't on board, kiss the capital goodbye." [10]

If Comcast and/or Time Warner decline to permit access to a new independent network, there is strong disincentive for other cable systems, for competitors and for investors to embrace it—as they all know the survivability of such a network is in doubt. Adelphia, which is one of only ten cable MSOs with more than 500,000 subscribers (out of more than 1000 MSOs total) has at times provided an important pathway for independent channels to launch and reach at least the first distribution milestone of 20 million homes. The absorption of Adelphia into Comcast and Time Warner will exacerbate the existing market imbalances to the further detriment of competition, consumer pricing, consumer choice and the diversity of ideas in the marketplace.

2. Discrimination Against Independent Networks

"He (Brian Roberts) was then challenged on any room for new [programming] services. He started with a story that CNN and other new channels were pushed by entrepreneurs not the cable companies, and then went on to essentially say Comcast was going to learn how to be an innovator of services and not let that happen again." [11]

Section I demonstrated that a few large, vertically integrated MVPDs have the *ability* to restrict competition in the marketplace and impede the flow of diverse programming to the consumer. This section addresses their strong *economic and competitive incentive* to do so, and notes a track record which demonstrates that networks affiliated with MVPDs and major broadcasters are routinely favored over those which are independently owned. These interests and behaviors create for independent networks a "perfect storm," in which the sole companies endowed with the power to bestow viability on an independent network have a growing stake in preventing competition from reaching the marketplace.

A. Incentives to Favor Affiliated Networks

Vertically integrated media companies have strong disincentive to embrace new networks. New independent networks are *competitors.* They compete directly with operator-owned networks on several levels: competition for viewers, competition for advertising dollars (including in local markets), and competition for channel capacity. And, cable operators know that a fully distributed network can be worth a billion dollars or more in asset value—and such value in the hands of independent persons or groups is foregone value to an operator.

Time Warner and Comcast have incentive to prevent content competition from entering the marketplace. Comcast Corporation currently has an interest in at least twenty networks and is developing additional ones. Comcast's attempt to acquire Disney, and its string of recent channel launches, including TV One, G4, PBS Kids Sprout, and the upcoming NY Mets regional channel and Sony-based networks, demonstrate a strategy of augmenting its cable channel assets. Time Warner Cable's parent company owns and operates at least 10 advertising supported networks in the United States. [12] While Time Warner does not break out financial data for each network individually, overall its television networks (which includes its ad-supported networks, premium networks, international networks and WB broadcast network) contributed 40 percent of Time Warner's operating income. [13] By comparison, Time Warner's cable division contributed only 28.6 percent of operating income. [14]

One way to protect the value of these assets, would be for Time Warner and Comcast to deny linear carriage to potential independent programming competitors, in favor of affiliated program networks who evidently either have the leverage to secure carriage, or have the ability to grant carriage to the MSO's networks in return. Clements and Abramowitz of the U.S. GAO, in their study of the impact of affiliation on programming carriage write, "*Vertical integration between cable networks and operators may be induced by transaction efficiencies, but serve to foreclose opportunities for new independent entrants."* [15]

In addition, the value to an operator of carrying an independent network, even a network which gives partial ownership to the operator in exchange for carriage

[10] CableWorld. April 4, 2005. "How Come the Vultures Don't Flock to Cable?" by Simon Applebaum.

[11] "Brian Roberts Comes to Sand Hill Road," *Technik: Thoughts on the new New New Thing, Duncan Davidson Blog,* June 17, 2005. Available: *http://yelnick.typepad.com/technik/2005/06/brian*_roberts_c.html.

[12] MB docket 05–192 Application 05–18–2005, Exhibit W.

[13] Time Warner Inc. 2004 Annual Report.

[14] *Id.*

[15] *Ownership Affiliation And The Programming Decisions Of Cable Operators.* Michael E. Clements and Amy D. Abramowitz. U.S. Government Accountability Office, p18.

and shares advertising revenue with the operator, cannot approach the value of carrying a channel which is owned completely—100 percent of the equity and revenue of an affiliate, versus approximately 5 percent of an independent.

B. Track Record of Preference

Preference by MVPDs for affiliated networks over independent networks has been well documented by independent research. Clements and Abramowitz of the U.S. GAO found that cable operators in general were *62 percent more likely to carry affiliated programming over independent programming*.[16] Furthermore, of the ten variables tested in the study, ownership by a cable operator had by far the largest marginal effect on predicting carriage of a network.[17] The researchers concluded, "*These results can also indicate the foreclosure of competition in the upstream cable network market, as independent cable networks are less likely to be carried than are affiliated networks.*"[18]

We reviewed the adoption of new affiliated and independent networks by Comcast and Time Warner, based on publicly available information during the period of January 1, 2003 to May 15, 2005 (a nearly 2½-year period).[19] Only networks which sought initial launch of their programming service during the period were included in this study. The results are stark and confirm severe dysfunctions in the cable marketplace. Ultimately these lead to higher consumer pricing, lower consumer choice, a stifling of competition and entrepreneurialism, and an adverse effect on our democracy and the diversity of ideas in the marketplace. Some highlights of the study are as follows:

- Over a 2½ year study period, less than 1 percent of independent channels secured national, non-premium carriage at either Comcast or Time Warner (1 out of 114 independent channels), and only 7 percent of independents received local carriage by either operator. In contrast, Comcast and Time Warner granted carriage to nearly two-thirds (63 percent) of affiliated channels which launched during the study period.
- Overall, 95 percent of networks affiliated with an operator or broadcaster received carriage of some kind vs. 13 percent of independents.
- Affiliated networks launching during the study period also achieved considerably greater distribution than independents—11x greater on a median basis, and more than 2x greater on a mean basis.

Furthermore, we believe that Comcast employs a different standard for launching its own networks than it does for independents. In the case of *TV One* (a Comcast affiliate), Comcast committed carriage to "a significant number of our markets" and $60 million in financing *prior* to the network hiring a CEO, hiring a head of programming and filling other key positions, securing a carriage commitment from any other operator, or (to our knowledge) producing or acquiring any programming. All of the deficiencies cited above were addressed by TV One months after Comcast made its commitment of carriage and financing. In fact, the scheduled launch of the channel had to be delayed because key management positions were still vacant, and TV One finally launched without carriage from any operator besides Comcast.

When Comcast's and Time Warner's preference for affiliated networks and behavior toward independents are considered in light of their market power, a dismal picture for independent networks emerges. It is the combination of these elements (ability to restrict competition, powerful incentive to restrict competition, and observable patterns of discrimination) within two vertically integrated MVPDs, which allows us to fully understand the reluctance of the venture capital community to invest in new independent networks.

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[16] *Ownership Affiliation And The Programming Decisions Of Cable Operators.* Michael E. Clements and Amy D. Abramowitz. U.S. Government Accountability Office, p16.

[17] *Id.* at 14. Majority ownership by a cable operator added 27.78 percentage points to a network's likelihood of gaining carriage.

[18] *Id.* at 16.

[19] This study is limited by the availability of public announcements regarding channel launches. Sources of data: All launch dates are according to company filings with the National Cable and Telecommunications Association, as well as publicly available sources. Ownership information, subscriber data and carriage information are all from publicly available sources, including the National Telecommunications Association, industry news sources such as Multichannel News and Kagan Research, as well as corporate announcements, filings and marketing materials.

3. Exclusion of Independent Channels Leads to Higher Consumer Prices, Reduced Competition and Other Public Harms

A. Consumer Pricing

The dramatic increase of cable rates is a common complaint from consumers, of which Congress regularly takes note, and a common response from the cable community is to cite higher license fees demanded by networks. Indeed, the GAO report on Competition confirms that the increase in programming costs is a major contributor to overall cable price increases. [20]

Of course, one reason for this is that certain cable programming networks are "must-haves" and their differentiation from other networks puts upward pressure on the license fees that operators pay. However, an examination of programming license fee data shows that *average fees and average price increases for affiliated channels, are significantly higher than for unaffiliated channels.* [21] New channels owned by large media companies are also more likely to charge license fees in their first year(s) of operations. [22]

The exclusion of independent channels therefore could directly contribute to rising cable costs which are well in excess of the rate of inflation. As such, there is a significant public interest in protecting free competition from independent programmers, on the basis of the merits without regard for affiliation. Among the findings:

Average License Fees

- The average license fee in 2005 for networks affiliated with MVPDs is *225 percent greater* than the average license fee for independent networks.
- The average 2005 license fee for networks (excluding ESPN) that are affiliated with a media company is *161 percent greater* than the average 2005 license fee for independent networks.
- The average 2005 license fee for Time Warner owned networks is *341 percent greater* than the average 2005 license fee for independent networks.
- The average 2005 license fee for Comcast owned networks is *121 percent greater* than the average 2005 license fee for independent networks.

License Fee Increases, 2002 to 2005

- Over the past three years (2002 to 2005), the license fees charged by networks affiliated with an MVPD or broadcaster increased more, on average, than did the fees charged by independent networks.

  —The average license fee increase from 2002 to 2005 for a network affiliated with an MVPD *was 88 percent greater* than that of an independent network.

  —The average license fee increase for a Time Warner affiliated network was 5.1¢, *more than double* that of an independent network.

  —The average license fee increase for a Comcast affiliated network was 3.3¢, *more than 30 percent greater* than that of independent networks.

  Excluding ESPN (which posted the highest increase in license fees), the average license fee increase for a network affiliated with any media company (MVPD or broadcaster) was *40 percent greater* than that of an independent network. The percentage was higher when including ESPN.

B. Competition

As discussed above, the addition of independent networks to a cable system is less likely to increase cable rates than the addition of comparable networks affiliated with MVPDs or broadcasters. In addition, free competition from these independent networks for carriage, tier placement, channel assignments and more would also put downward pressure on the license fees which MVPDs are required to pay to many comparable networks, affiliated and independent. The removal of unreasonable barriers to entry for cheaper and more efficient independent networks and the competition which such entry brings can cause high-priced affiliated networks to become more efficient, reduce their rates or otherwise improve their value proposition—all of which would redound to the benefit of the consumer.

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[20] Government Accountability Office, "Issues Related to Competition and Subscriber Rates in the Cable Television Industry," October 2003, at 20.

[21] Economics of Basic Cable Networks 2006, 12th Annual Edition, Kagan Research, p55.

[22] NBC, for example, is launching a new linear channel, Sleuth, in January 2006. Despite the fact that Sleuth has no original programming, the *Wall Street Journal* reports a license fee of 13 cents per subscriber per month, "a high fee for a new cable network." (WSJ, 11/3/2005, *NBC Plots a Crime Channel*.) In terms of fee per subscriber, this would immediately put Sleuth in the top 33 percent of the 123 networks ranked by Kagan's 2006 annual cable report.

It is not the entry of one more Viacom or Time Warner network that will create this downward pressure on consumer pricing. These and other conglomerates who own the majority of widely distributed networks have little incentive to encourage price competition among networks. The public, however, has an interest in fair access for entrepreneurial ventures—independent programmers—which will expand competition in the marketplace and likely place downward pressure on license fees paid. The continued restrictions on entry have had and will continue to have the opposite effect: steady increases in programming costs and hence, upward pressure on consumer pricing.

C. Diversity

The top cable operators have purported that there are 196 independent networks (a number which has been deconstructed in various FCC filings), and that this proves diversity. But the facts demonstrate an increasingly narrow ownership structure, and a market which is becoming increasingly off-limits to independently-owned ideas. A quick look at the list of 92 networks distributed to more than 20 million households reveals that roughly 76 percent are owned in whole or part by one of six companies Disney, Viacom, NBC Universal, News Corp, Time Warner and Comcast. In addition, only 9 of the 92, and only 3 of the top 50, are not owned in whole or part by a large broadcast company or MVPD.

In a typical marketplace, the preferences of the buyers determine what goods will ultimately be created and offered by sellers. Production companies will not invest resources to develop programming for which there is no market. It is the network, the purchaser of the content, which ultimately determines which content will be produced, who will produce it and importantly, how the production will handle the underlying subject matter. Network ownership brings control or influence over the selection of top management, who, in turn, are responsible for these editorial decisions. Hence, diversity of television programming is ensured by increasing the diversity of network ownership.

4. The Future of Independent Networks

Despite the best intentions of Congress and the FCC, two cable operators have emerged as gatekeepers to network survival and the free entry of competition into the marketplace. These two operators have incentive to prevent additional competitors from entering the market, and a track record of denying competitive opportunities to independent networks.

Independent networks serve several crucial roles in the programming marketplace. They introduce new competition among programmers and apply downward pressure on programming fees. They can often create an entirely new market for programming of a specific genre or niche, and in doing so increase opportunities for independent producers; they also increase the number of potential buyers for more mainstream original programming concepts and existing content and this competition in turn promotes investment in independent production companies and leads to the creation of high quality programming.

The health of competition, consumer pricing, consumer choice, the diversity of ideas in the marketplace, and the quality of our national discourse depend on a level competitive playing field for independent programming services.

The CHAIRMAN. Well, thank you very much. And we appreciate your brevity.

Mr. Polka, one part of your statement you did not read pertained to the past discussions on this Committee of the problem of decency on television, and you mentioned the question of putting together packages that included items that had high sexual content when you were trying to put together a children's program. What was the outcome of that negotiation?

Mr. POLKA. Well, sir, the outcome is that the program services that you were referring to were carried, and that's the nature and the function of the contracts today. When we talk about cable programming and how it's packaged and priced and dictated, in terms of contract, the wholesale programming practices that we refer to, that is what is causing the problem. Where you have situations where family-oriented program that we want to carry is oftentimes bundled and required to be carried with other program services.

The fact is that, at the end of the day, in most cases those services are carried, because that is the best way to carry that family-oriented programming at the cheapest price.

The CHAIRMAN. Do you use a rating system in your programming?

Mr. POLKA. We do not. We do not use a rating system. But I can tell you that our customers tell us about what they think about the programs on television. I can think of cable systems where more than half of our subscribers walk into our cable systems month after month to pay their bills, and I can tell you, based on their rating system, that they're not happy. And they're telling us—and we are here to say that we would like to provide more choices to our customers, and that means programs that we could package in tiers of service that we could do today—it's not a mandated a-la-carte system, but tiers and packages of services that we could put together in our marketplaces today that would meet our local community's needs, working with our customers to provide them more family-oriented programming. The problem is that the contracts that we have to take from the major media conglomerates force us to carry those services, their services, on either the basic or the expanded basic level of service.

The CHAIRMAN. OK. Thank you very much.

Mr. Pyne, do you charge the smaller cable companies more for programming? When you say that you charge the price, is the price for smaller cables larger than a price to the larger cable company?

Mr. PYNE. Mr. Chairman, there is something known as the National Cable Television Cooperative, which conglomerates, or is a co-ops of systems that represent roughly 8 million subscribers. And through that co-op, we license smaller cable operators, and we treat that group as if they were an 8-million-subscriber MSO in an effort to bring price parity to the smaller cable operators. And we do that across our networks, from the ESPN side to the Disney Channel, ABC Family, and so forth.

The CHAIRMAN. Mr. Lee, how would you be affected if retransmission consent was changed to prohibit requiring bundling of programming in the case of small cables with few subscribers?

Mr. LEE. Mr. Chairman, in our world, the world of a local television station, there's very little bundling involved. In my negotiations with the MVPDs, there are companies that pay us cash, because that's what they prefer, there are companies that take one extra channel, there are companies that take two extra channels, and, in that case, they do so because that works better for them. In our part of the world, satellite subscription is at almost 40 percent of television households, and suddenly the cable operators have become my new best friend. They tell me they want programming that is unique to them. A cable operator will often say to me, "What can you produce for us that our subscribers won't be able to get on DIRECTV or DISH Network? So, I think the marketplace is solving this question rather efficiently.

The CHAIRMAN. I'm going to yield to my colleague, Senator Dorgan, for comment or questions.

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

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

First of all, I thought the testimony was interesting and very well done, from different perspectives. I'm not sure I'm better informed as a result of it. It is really pretty complicated, number one, and, number two, there are some very significant competing interests. And I'm not sure where all the merits exist at this point. And I want to ask a number of questions.

First, Mr. Pyne, I suppose I would not purchase a cable service if it didn't have ESPN attached to it, just my preference as a consumer. I've had a fellow that runs a small cable service in North Dakota for years constantly complain to me about the increased cost of content coming up through, for example, ESPN. I don't know what your price increases are year to year, but he says, you know, "I've got to pay whatever it is, because I can't offer cable service without ESPN." So, tell me—I mean, I assume that's the case, whatever it is you pass along, that cable operator's going to have to pay in order to have ESPN on their cable menu, because otherwise people are going to say, "Wait a second, we won't take your cable service." What kind of inhibiting factor exists to keep your prices down, on ESPN, for example?

Mr. PYNE. Well, over the last several years, we have actually negotiated with virtually all of our major providers, including the National Cable Television Cooperative, which would represent smaller operators, cable operators. And, as part of those negotiations, we actually are committed by contract to certain price increases. And over a period of time, those increases went from a level—20 percent down a level of 7 percent, through the aspect of these long-term agreements. So, by law, I mean, we have an agreement with the National Cable Television Cooperative that specifies exactly what our rate increases or price increases each year are.

Senator DORGAN. All right, I will——

Mr. PYNE. And——

Senator DORGAN. Perhaps we can talk at some other point. I'm kind of interested in this notion of—you're able to pass along almost anything. I mean, I understand you have a contract here, but we see these announcements of prices that are paid for various events and so on, and it just gets passed along to the consumer out there by a cable operator that can't afford not to have ESPN. And I say that in a complimentary way, because I think what you offer is something I want and many other consumers want.

Let me get to this question of—Mr. Gorshein and Mr. Fawcett, I guess, both—The America Channel. Is it America or America's Channel?

Mr. GORSHEIN. America.

Senator DORGAN. America Channel. You, in your testimony, talked about the difficulty of getting access. Can you describe your difficulty in getting access? And you're quoting others to say, you know, there's just no chance for an independent to start up here and have access and be successful. And then, let me ask the folks on the other side of this transaction to tell me about your difficulty or what they perceive is your ease of getting access if you have the right programming, I suppose. So, why don't you tell me, first of all, What are the impediments for an independent?

Mr. GORSHEIN. The impediments for an independent are that we compete with Comcast and Time Warner, in effect, today. So, when they look to an independent, they say, "Well, gosh, it can give me incremental value, in terms of receptivity at the consumer level. But their own networks give them 100 percent of the equity, 100 percent of the revenue, 100 percent of the ad avails, and their own networks are positioned in a way so that—you know, we compete for viewers, for capacity, for ad dollars; and because we're a free channel for several years, we apply downward pricing pressure. So, there is an inherent economic disincentive to work with an independent channel.

We have always said that this is not about us. Let's assume that The America Channel isn't the best product in the world and that the telcos are all crazy for embracing us. The fact is that you cannot run away from the statistics, from the empirical evidence on the ground. And the empirical evidence is that less than 1 percent of independent channels over a two-and-a-half-year study period got national carriage, most affiliated channels—that is, affiliated with a cablecaster or a broadcaster; and we have different definitions of what independent is; they believe it's everybody other than Comcast—they carry 100 percent of their channels. They carry close to 100 percent, if not 100 percent, of their channels on analog. So, the basic difficulty is that I'm a competitor.

Senator DORGAN. And, Mr. Waz, what are the standards that Comcast would use to determine whether to carry an independent network? And are they the same standards that you would use to make a decision about carrying an affiliated network?

Mr. WAZ. Senator, our standard is, we always want to offer the best programming we can from whatever source it may derive. And if we don't, DIRECTV will. And if DIRECTV doesn't, EchoStar will. And if they don't, as the telephone companies enter the market, they will. So, we get scores of new ideas brought to Comcast every year, from large and small media companies, for new programming concepts. The ones that succeed are the ones that have a strong programming concept, something to show us, actual content, which The America Channel doesn't have, financing that's in order, programming talent—they show they know how to operate a network, and they have operating experience; if it's an existing network, we like to see that they have some Nielsen ratings and a commitment to get the product started. The America Channel, I know, has slipped its starting date several times now, and I don't know when they really intend to sign on the air. They're not on the air at this time.

I would contrast The America Channel situation with something called The Sportsman Channel, which is one of several new independents we've had in the last several years. Michael Cooley did an article in Multichannel News that I submitted for the record, and I thought he stated the situation for independent programmers very clearly "it is incumbent upon a programmer to make the case to a Comcast, a DIRECTV, a DISH Network as to what the business reason is for them to be carried." Interestingly, The America Channel has, with one small exception, reached an agreement with no cable operator, with no company, like RCN or Knology, or WOW! It has not reached an agreement with DIRECTV and has not reached an agreement with EchoStar. I think that says something about the caliber of what's being sold.

Senator DORGAN. Mr. Gorshein, go ahead.

Mr. GORSHEIN. The letter from the channel that the gentleman from Comcast is referring to—that's the one out of 114 channels that got carriage during our two-and-a-half-year study period. Comcast and Time Warner have market power which exceeds their market share. If you don't get carriage at Comcast, you are viewed with skepticism elsewhere. And we've been told that by other cable companies. Comcast will not fund and produce and do all of the things necessary with one of their own channels until Comcast commits to carry their own channels. They know that. So, the critical barrier to entry is for Comcast to say, "We will let you in."

Senator DORGAN. Let me ask—Mr. Lee, I think you've said that the retransmission consent issue is working just fine. The marketplace exists and is just fine. You——

Mr. LEE. I believe it is.

Senator DORGAN. You, I think, also said, you know, perhaps in an agreement someone might ask that you carry another channel.

Mr. LEE. Yes.

Senator DORGAN. Isn't it the case that sometimes it's more than another channel? A couple of channels, more channels than that, even?

Mr. LEE. Senator, in the case of our own television station in Roanoke, it is, in fact, a fact that, in addition to the primary channel, we produce and offer to the MVPDs two other channels, some carry both the other channels, some carry one other channel, and some carry only the primary station.

Senator DORGAN. I'll follow up on that, but let me ask about—I had some people come in to visit with me about the question of whether someone who's providing content, a video distributor trying to offer a channel, and whether the distributor—if the distributor feels that channel is inappropriate for that local market, whether they ought to be able to determine it be on another tier. We've had some complaints about that. Should a video distributor, for example, be able to, in these negotiations, prescribe on which tier a channel is aired, or a video programming is aired?

Mr. LEE. Senator, I'd be inclined to defer to my colleagues who are in the MVPD——

Senator DORGAN. Mr. Polka?

Mr. LEE.—business to comment on that.

Mr. POLKA. Yes, sir, we believe they do. We believe that operators in the community who are closest to their customers and who know their customers, would be the best ones to make that decision.

Senator DORGAN. And that is not now the case?

Mr. POLKA. That is not now the case, because of the nature of the contracts for those programs, which mandate that carriage of channels are carried on either the basic or the expanded lowest levels of service. So, despite the fact that we receive numerous complaints from our customers concerning content today on television carried on expanded basic, there is nothing we can do about it as it relates to these contracts.

And there's one other thing I would say about your question concerning rates and disclosure, particularly with the National Cable Television Cooperative. There is no way for you to know, unless you could actually someday see the contract. But, today, that will never happen, because of disclosure and confidentiality provisions in contracts that prohibit you, the FCC, my consumers, local franchising authorities from finding exactly what the price increases are year after year. And the only thing I would suggest to that is that the FCC annually surveys cable rate increases, why shouldn't the FCC also annually survey programming rate increases, programming rates, terms, and conditions? That way, you would be able to answer that question. You can't answer that question today.

Senator DORGAN. Mr. Chairman, this is an interesting and a complicated area, and I'm trying to understand more about it and will. I read some about it last evening, and have some just casual acquaintance. But, as a last question, we've had some discussion about the Adelphia transaction, and I know that when News Corp acquired DIRECTV, there were some conditions imposed with respect to that acquisition, and I'm interested. Several of you actually mentioned the issue of Adelphia and the potential of a lockup of local sports arrangements. Perhaps we could have a bit of point/counterpoint about that.

Who believes very strongly that need to be some conditions imposed on the Adelphia? Mr. Fawcett?

Mr. FAWCETT. Yes, the conditions that DIRECTV has been suggesting on the Adelphia transaction are very similar to those imposed on News Corp when it purchased the interest in DIRECTV. The difference there is that News Corp—DIRECTV only owned 13 percent, or controlled 13 percent of the households in the U.S. In these local markets where Comcast or Time Warner will become hugely dominant, they will control 70 or 80 percent of the subscribers in a market, it's much easier for—when you have that type of market share—to negotiate exclusive contracts or to, you know, hold the competitors, DIRECTV or EchoStar, which owns less than 20 percent of the market, up for ransom and extraordinary rates, which, frankly, are passed on to the consumers. And it's programming that has been deemed to be must-have programming by the FCC, and we can show, in markets where we don't have local sports programming, our growth has been much slower than it has been in our—our market share is much less than it would be had we had the sports.

Senator DORGAN. And who thinks Mr. Fawcett is losing sleep over a nonissue?

Mr. WAZ. I'll take a shot at that, Senator.

Senator, the Adelphia transaction deserves to be approved, and it deserves to be approved in a timely fashion for several good reasons. The first is——

Senator DORGAN. With conditions or without conditions?

Mr. WAZ. Without conditions, sir.

The first is, the company is in bankruptcy and is not being operated for the future. So, millions of cable customers in Adelphia communities across the country are not getting video on demand, they're not getting telephone service. Their systems are not being managed for the future. Comcast and Time Warner, between the two, are prepared to invest a $1.5 billion to make the future happen. So, we would like to see timely approval, without conditions.

The conditions that are being described by Mr. Fawcett are unnecessary and are not relevant to the merger transaction. In most of the markets that he talks about, Comcast is growing a fraction of a percent or a few percent. There is not a substantial change in the market share that Comcast has in most of the markets where there are sports networks.

And I'd be delighted to speak to his point about the inability of DIRECTV and DISH Network to compete in markets where they don't have sports rights. There's exactly one market that I'm aware of that—where Comcast is involved—where DBS does not have the sports rights. That's Philadelphia.

In Philadelphia, DIRECTV and DISH Network have a market share of about 12 percent. That's higher than Boston, higher than Springfield, higher than New Haven, almost as high as Baltimore, higher than several other major urban markets. So, there has to be something else at work besides the absence of sports programming on DIRECTV in that market to account for those numbers. They're larger than many of the other markets I mentioned.

And one additional point. Both DIRECTV and DISH Network had available to them, in the late 1990s, over a hundred games of the Phillies, the Flyers, and the Sixers for free if they would carry the local broadcast station in Philadelphia that offered those signals. They had the right to start carrying that signal for free in 1999. They did not choose to carry that signal until their version of the must-carry rule kicked in, in 2001. So, you would think, if this is essential content, that they would have carried the games that were available for free.

Senator DORGAN. Mr. Chairman, you and I, in years past, have both expressed concern about concentration in broadcasting and so on. I think the bottom line with respect to all of this testimony and these discussions is about the marketplace. Is the marketplace a marketplace that functions? Is there competition? Are the normal forces in the marketplace working to provide the best for the consumers in this country? Because only in a marketplace that works will we have, I think, the kind of opportunities that we would want to have exist for America's consumers.

And I don't know that I know the answers at this point, but I think the testimony offered today is helpful, and I appreciate very much, Mr. Chairman, your holding the hearing.

The CHAIRMAN. Well, thank you. I find, really, we're both going to be the mouthpiece for questions that others would ask if they were here. And sometimes I have difficulty understanding the question I'm supposed to ask you. So, it becomes a little bit of a problem.

But let me go to you, Mr. Waz. Exclusive contracts are forbidden for satellite-delivered programming only. Now, why should we not remove that and make the concepts that are applied by FCC apply across the board?

Mr. WAZ. Senator, again, when the 1992 Cable Act passed, Congress did not apply these rules to all satellite-delivered programming. A program network that is owned by a Disney or a Viacom or NBC Universal or another company that's not in the cable business is not reached by these rules. And terrestrial programming, as you've suggested, is not reached by these rules. There were about a dozen terrestrial networks in operation when Congress passed this bill in 1992, so we think Congress knew exactly what it was doing in exempting terrestrially delivered programming.

The CHAIRMAN. Well, that's just because we didn't have a crystal ball.

Mr. WAZ. Well, I think the crystal ball worked, sir, because I think you were trying to place predominant reliance on the marketplace. You said, "We're not going to try to turn every program into something that has to be given away, so that no one can have any exclusivity." And, frankly, I think some amount of exclusivity in programming is what permits us and DIRECTV and EchoStar and the phone companies to distinguish ourselves from one another. The terrestrially delivered programming, in particular, tends to be local programming. It can be news, it can be public affairs, it can be sports. And Congress said, at the time, you did not want to chill investment in better local programming.

The CHAIRMAN. What difference does it make, if they're bundled when you get the programming out?

Mr. WAZ. Well, Senator, I know there's been a lot of discussion of how programming is sold in bundles this morning with retransmission consent. We're not a broadcaster, so we don't have a bundling issue of the sort you're describing.

The CHAIRMAN. Well, this is the so-called "terrestrial loophole," as I understand it—does not that affect cable-delivered programming?

Mr. WAZ. It does. Terrestrially delivered programming that is created by a cable operator or a phone company or anyone else would be exempt from those rules.

The CHAIRMAN. Do you oppose eliminating this difference between the satellite-delivered programming and all other programming?

Mr. WAZ. Senator, with so much competition in the programming marketplace today, with DIRECTV having access to so much programming, and we do, and all the other competitors do, I think there's less reason for expanding regulation, and more reason to reduce it.

The CHAIRMAN. Let me go back to the statement that you made, Mr. Gorshein. You said, "We have secured distribution no less than six telcos, close to 90 percent of the projected telco video spaces, including Verizon, AT&T, and others. Channels that have been 90 percent off cable—of cable space have been around for 25 years. In telco, we did it in 5 months, in contrast to our success in telco, after close to 3 years, we had virtually no progress in getting carriage from dominant cable operators."

Now, my question to you is, Why do you need it, if you've got all that other type of access?

Mr. GORSHEIN. The telcos have big names and lots of customers. The problem is, they're not video customers today. Our fate is inextricably linked to theirs, so that if they can penetrate local markets quickly, that certainly helps us. And so, we're very much in favor of telco relief. That will give us more outlets, and independent competitors like us more outlets.

Statistically, empirically, if you look at the data, there are 92 channels which hit the critical viability threshold of 20 million. That's the minimum you need to get Nielsen's. And the cable operators and the broadcasters have gone on record at the FCC to say 50 million is actually the bare minimum you need to have a profitable venture.

Of the 92 channels that hit 20 million, 91 of them had to secure carriage at Comcast and Time Warner, one secured carriage at one of Comcast or Time Warner, but also secured Adelphia, which suggests that, post-transaction, it will be empirically impossible for a new channel to succeed without the transacting parties.

I will also say that there's no precedent for a satellite-only channel reaching that viability threshold.

The CHAIRMAN. Well, as you know, we've been exploring the concept of having some means to have a family tier offered, no matter what the source of the programming. All right? And to have, in connection with that family tier, a rating system so that whether you're using the V-chip or whatever kind of thing that's available to you, the family has a way to check what they do not want their children to view.

Now, if we did that, tell me, right down the line, how would that type of legislation affects your business?

Mr. Pyne, how would it affect you?

Mr. PYNE. I think we have come out to say that we support the decency standards for broadcasts across all of our networks, whether that's ABC Family, Disney Channel, ESPN, and so forth. Sports and news are generally not rated, and we support not rating sports, specific sports and news——

The CHAIRMAN. You'd support it, but it doesn't really affect the way you do business.

Mr. PYNE. No, sir.

The CHAIRMAN. Mr. Polka?

Mr. POLKA. Thank you, Mr. Chairman.

The more information, the better. That's very helpful—to myself, as a parent who makes decisions for my children, as well as for our customers. However, at the end of the day, even with a different rating system, the channels still would be coming into the home, and they would have to be blocked, they would have to be kept away from those that parents might want to keep it from, whether it's their children or otherwise. So, the point is that the programming that you find most objectionable is still coming into the home. The only way that we can actually make changes to actually give consumers more choices is to get them into the process. They are actually not in this process of deciding what's on their television today. And if they were, in conjunction with their operators, then packages of programming services would be developed in local communities that they would take and pay for.

The CHAIRMAN. Well, as far as this Senator is concerned, I don't think we should mandate what happens. I think we should mandate that there should be a system where parents can control what their children have access to.

Now, having said that, the difficulty is, I don't know if you went down to see this, Senator—when we went down to see the rating system, guess what was left out? Sports. Sports aren't rated. History concepts, they weren't rated. Now, how do we get into the system so somehow or other we achieve the objective I think we all want, and that is—no, I don't want my grandchildren watching some sort of smut, but I don't object to it being out there if someone else wants it. I want my children to have the right to block it. OK? Now, why can't we get together and find some way to do that? There seems to be a resistance to the rating system. There's a resistance—there's general agreement on the block. We haven't had a witness that has—well, we did have one that came on. He represented, really, the people who are providing the programming of very highly sexual content, but he also agreed it should be rated. But what's your solution for that? You say you'd like to do it, but you don't want us to do it, right?

Mr. POLKA. That's right. We don't think Congress needs to. We think that—again, just as you said, I mean, you can look at content, and you can make a decision. You can determine whether or not you find it objectionable or not and whether you would like to pay for it on this particular tier or not. And that's essentially what we're suggesting. Rather than allowing the content to continue to come into the home without any accountability or change whatsoever, basically giving consumers more choices, working with their operators, to be able to say, as they say to us month after month, "We would not—we would prefer not to have this channel on expanded basic. Can you please sell us that, or not sell it to us, so we don't have to take it?"

The CHAIRMAN. What do you think, Mr. Lee?

Mr. LEE. Mr. Chairman, I'll speak to this more as a parent than as the operator of a local television station. I think a solution may be in place already. We have a daughter who's now 24 years old, but in her youth there were a couple of cable channels I found objectionable. And, to the credit of the local cable company, when I called and made that observation, they had, by the following day, come out to the house, taught me how to block it on the set-top box, and then trapped it on the pole, so the channels that I found objectionable were, within 24 hours, gone.

The CHAIRMAN. That required you to know in advance what channels were bad, right?

Mr. LEE. Yes, but I could tell pretty readily.

[Laughter.]

The CHAIRMAN. Well, then you're better than I am, because I remember sitting there and watching "Rome," and I thought it would be a great historical program, and suddenly I found out to the contrary.

[Laughter.]

Mr. LEE. But, Mr. Chairman, if I could——

The CHAIRMAN. I enjoyed the program, but I would not have wanted my granddaughter sitting next me.

Mr. Waz?

Mr. WAZ. Senator, David Cohen from Comcast came before this Committee a couple of weeks ago and talked about the family tier that Comcast has established with some great family-friendly brand names, like National Geographic, Disney and Discovery. So, we are trying to be responsive to those in the marketplace who really want a family tier alternative.

To your broader point, absolutely, parents need to know about ratings systems. And parents need to have the tools to be able to act on ratings and to be able to decide what's appropriate for their families. We are strong supporters of making sure that people know what the rating system is, how it works, and how to use the equipment we can make available to them to make all television in their homes family-friendly.

The CHAIRMAN. My staff director reminds me that the contract we had from our State was that it was not possible to offer a family channel, because networks require that the vast majority of the customers—that their customers receive, in terms of channels, are all aimed at adults. And unless the programmers agree to change the contract, there's not going to be a family tier in Alaska.

Now, Mr. Fawcett, you said you go up Alaska, right?

Mr. FAWCETT. Sorry?

The CHAIRMAN. Does your programming go to Alaska?

Mr. FAWCETT. Sure. And—I mean, on—just on this point, I'd like to—you know, my testimony here in November revolved around the fact that DIRECTV, since day one, has been 100 percent digital, and every subscriber to DIRECTV has the power and the ability to block out channels through our locks-and-limits feature, which is not just channels——

The CHAIRMAN. How do they know that in advance?

Mr. FAWCETT. There's a channel on DIRECTV that shows that information every half hour. It's in the owner's manual, and our installers——

The CHAIRMAN. That's how you block it, but how do they know about the content?

Mr. FAWCETT. Well, there are ratings that are passed through by the programmers, so each program that is rated, that information is passed through, and then, through the locks-and-limits feature, that would be blocked, if that's what you chose—if that's what you, as a parent, chose to do. If it's not rated, our technology allows you to block unrated programming or programming of—you know, on any specific channel or at any specific time of the day. So, our subscribers that are parents have full power to block any programming coming through on DIRECTV.

The CHAIRMAN. We're informed that the meeting that our colleagues are at, on both sides, will not end in time for them to be here. So, I'm informed that they would like to have the right, some of them, to offer questions that we would submit to you. I would hope that you would give us the courtesy of responding to their questions. I apologize for the problem that's going on right now with regard to these meetings of the two sides of the aisle.

The CHAIRMAN. My last question would be to you, Mr. Fawcett. If Comcast says it maintains a competitive marketplace for video content, and it's working, why aren't there enough options for sports programs contracts available to DIRECTV to respond to the large cable companies reaching sports networks? Why aren't there enough there for you?

Mr. FAWCETT. Well, as I said, we have been able, until recently, to provide local sports programming. It's what's been happening. In Philadelphia, obviously, we've never had the ability to provide local sports programming, and our penetration in Philadelphia is the lowest of any of the top 25 DMAs. And, contrary to what Mr. Waz says, in San Diego and in New Orleans, where we also do not have local sports programming, our penetration in those markets, as well as EchoStar's, is much lower than it should be.

We have submitted a report to the FCC that has a regression analysis and smooths out the differences in some of the markets that he pointed out that we're also low in. In Philadelphia, for example, when it's adjusted, our report shows that our penetration should be twice what it is currently. And we—and that's really because we haven't been able—been afforded the right to carry the local sports team. There's no substitute for local sports programming. And what they would like to do, and what they have done over the past year, is not deny us access completely, but give us the Hobson's choice of a very high rate. And, if we choose it, great, everybody—they make out, because they own the—they own the network, and, if we don't carry it, then they have exclusivity. So, cable has a huge market advantage in a market where they have 70 and 80 percent penetration in market share.

The CHAIRMAN. Your discussion disturbs me a little bit, because I've been one who believed, primarily, that the concept of competition would ultimately lead to lower consumer prices and to greater access for consumers. But the conclusion I get here, that it's because of some of these concepts, which may be exceptions to the rules that we try to lay down, are leading to increased control of some entities over the marketplace and denying access to some people who have selected one provider, like for example, ESPN or to some program that they want. Now, I don't know that we can legislate it, but I certainly would be willing to look at any suggestion any of you have to level this playing field so that we—how long are these contracts you all enter into, by the way?

How long are the retransmission consent contracts? Who sets the——

Mr. LEE. In the case of broadcast, 3 years.

Mr. POLKA. It's 3 years. The cycle is 3 years, that's correct, Mr. Chairman. However, in case of the affiliated programming contracts that are oftentimes tied to those, those contracts are oftentimes for 5 years or more. And that's typically a tactic that we see in wholesale programming practices, where, in return for the carriage of the station, we're required to carry an affiliated channel for more than 3 years. In 3 years, they can come back and ask for another channel. So, more content then results on expanded basic that consumers have to take and pay for, whether they want it or not.

The CHAIRMAN. Has anyone explored the possibility of a provision in our law that says if you offer a contract to one entity, you must, up to your capacity, be willing to offer a similar contract to any other entity that seeks that service?

Mr. POLKA. We would support that.

Mr. PYNE. Senator Stevens, can I——

The CHAIRMAN. Would you oppose that, Mr. Waz?

Mr. WAZ. Well, Senator, I guess one good example is with the NFL, which DIRECTV has exclusively. Comcast cannot get NFL games. Its competitor, DISH Network, cannot get NFL games. One could pass a law that says all the NFL games have to be available to all competitors, just as one could pass a law saying all Philadelphia sports has to be available to all competitors. But I think we're at a point in the competition among networks here where we're better off if DIRECTV can compete with Comcast by having something unique, and Comcast can compete with Verizon by having something unique, and so on. The competition among those providers is a better way to make sure consumers are served better, because we're differentiating ourselves from one another.

The CHAIRMAN. Well, but doesn't it end up, as one of—I think it was Mr. Fawcett who indicated that some communities are shut off from their own team?

Mr. WAZ. No, Senator. In Philadelphia, as I indicated in my prepared testimony, there are over 100 Flyers, Sixers, and Phillies games on broadcast television; games that DIRECTV chose not to carry for 2 years when they were available to them. And when we acquired the rights of the Philadelphia 76ers, the previous owners had taken all the games off broadcast TV. We chose to put them back on because we wanted all fans in Philadelphia to be able to see the hometown teams.

The CHAIRMAN. Mr. Fawcett, it looks like——

Mr. FAWCETT. Can I respond to that?

The CHAIRMAN.—you want to respond.

Mr. FAWCETT. I was astounded to see, in Comcast's testimony, that we have the right to carry sports events on local broadcast stations. We did not get that right until SHVIA, in—so, we didn't have the right before, and once we obtained the right, we launched satellites, at considerable expense, and we carry all the broadcast stations that carry those local sports events in Philadelphia. A lot of those sports events, however, have left the broadcast television stations and have migrated over to Comcast SportsNet Philadelphia, which is a network they refuse to give—let us carry.

And the distinction between NFL SUNDAY TICKET is one that shouldn't go unnoted here. And that is, SUNDAY TICKET, which is our exclusive service, enables you to, in addition to getting your local team's games or the local games carried on the local broadcast networks, to get every other game played in the NFL. And that—you know, we negotiated that—for that right with the NFL. The NFL had open negotiations. And Comcast was in there bidding for the same rights. And, you know, as a—we had 13 percent market share, and the NFL wanted to grant exclusivity to that. But, again, it's an enhancement to what customers already receive. I'm from Pittsburgh, and if you said—if you're a fan of a Pittsburgh team and you can't get Pittsburgh sports on DIRECTV, you're never going to become a DIRECTV subscriber; you're going to stay with Comcast. So, it's a different—local sports are different than having this enhanced package of all games.

The CHAIRMAN. Well, on behalf of our Committee, I thank you very much. And, again, I'm sad that this has taken place at a day when I think many people that have different questions than I've asked you are not here, I urge you to give us your response to their questions as quickly as you can. And I thank you very much for your courtesy of appearing here today.

Thank you.

[Whereupon, at 3:50 p.m., the hearing was adjourned.]

A P P E N D I X

PREPARED STATEMENT OF HON. DANIEL K. INOUYE, U.S. SENATOR FROM HAWAII

Access to video content has become a particularly complicated matter over the years. As the methods of distribution have matured so have the rivalries and disputes. It appears that every party involved has one grievance or another.

The issues we are examining today have wide-ranging impact. Subjects like retransmission consent and contract exclusivity have the potential to affect the digital TV transition, prices for video programming, the future success of independent programming, and much more. We must be vigilant to ensure that exclusive arrangements for video content do not hinder robust competition and entry in the video market.

It is my hope that we can find a way to balance the competing perspectives in a manner that gives consumers more options while promoting full and fair competition.

PREPARED STATEMENT OF HON. JOHN ENSIGN, U.S. SENATOR FROM NEVADA

I want to thank Chairman Stevens for these hearings. I am excited that we are embarking on an aggressive series of hearings to examine all of the key issues related to telecommunications modernization. I also understand that we postponed the hearing on franchise reform this morning because of the Alito vote at 11 a.m. *and* my car accident yesterday—thank you to Chairman Stevens and Co-Chairman Inouye for thinking of me—I am pretty sore today. But I am very anxious to participate in the video franchising hearing when it gets rescheduled.

I believe that the current system of requiring new entrants into the video business to go city-by-city across the United States and engage in lengthy, expensive negotiations is anti-consumer and anti-competitive. We have heard loud and clear from the telephone companies that they want to deploy an exciting new service—IPTV—and invest billions of dollars and create jobs doing it. The problem is we have an outdated monopoly-era regulatory structure in place in the form of 33,000 plus local cable franchise authorities that are stalling deployment of these exciting new services. Presuming that we can pass a bill to reform these outdated impediments to IPTV deployment, a critical issue we must also address is the *ability of these new entrants to have programming to provide for their consumers to enjoy.*

There is a precedent for Congress acting on this issue. In 1992, when Congress successfully helped create new competitors in the form of satellite providers (DISH Network and DIRECTV), we recognized the need to help these new companies get access to the content of vertically integrated cable companies. Congress understood in 1992 that the incentives would be all wrong for a cable company that also owned video programming—cable channels—to make them available to their new competitors. So, in 1992, Congress implemented what is now Section 628 of the Communications Act.

In my legislation, the Broadband Investment and Consumer Choice Act—S. 1504, I would include an modernized Section 628 to extend a similar provision for any new entrants into the video space. To be consistent with the rest of my legislation, we have taken the existing Section 628 and amended it to eliminate the distinctions between cable and satellite and IPTV wherever possible. This is a technology neutral approach to ensuring consumers get the programming they want, to help speed competition in the video sector. We do not prescribe rates, or terms of the agreements, but rather encourage commercial arrangements between companies.

Just as Congress did in 1992, we have included *sunset* language (in fact the same *sunset* language)—the thought being that IPTV and other new video entrants will have 10 years to try to develop programming and content of their own so they can negotiate fairly with vertically integrated cable companies. If they are unable to develop market power to be able to successfully negotiate, the FCC will have the same exact authority to extend beyond 10 years that Congress granted satellite in 1992.

Franchising reform is the critical first step, and this video content language will help ensure that competition is successful and that consumers have the programming they want.

I look forward to working with Chairman Stevens and my colleagues as we work to address these issues.

PREPARED STATEMENT OF HAROLD FELD, SENIOR VICE PRESIDENT, MEDIA ACCESS PROJECT

THE "SWITCHING EQUATION" AND ITS IMPACT ON THE VIDEO PROGRAMMING MARKET AND MVPD PRICING

One of the most frequently debated questions in media policy is whether direct broadcast satellite (DBS), terrestrial cable overbuilders, or potential new entrants such as the incumbent telephone companies, provide competition to traditional incumbent cable operators, such as Comcast. Specifically, competitors to cable say that if Congress does not provide access to regional sports programming and other programming not covered under the existing "program access rules." [1] then cable will continue to raise rates and control the programming market. Independent programmers say they have no chance to get distribution unless they satisfy the demands of the two largest cable companies, Comcast and Time Warner. Cable companies, however, argue that if they raise prices too high or favor inferior affiliated programming over better independent programming, customers will switch to competitors.

Until now, the economic debate between parties has focused primarily on the incentives of the programmers, competitors, and cable incumbents. This white paper suggests that a focus on competition should focus on the *consumer*. In particular, if Congress intends to adopt policy on the basis of predicted competition between incumbent cable operators and potential competitors, Congress must first determine whether or not consumers are likely to switch to competitors. If consumers are unlikely to switch, particularly if the incumbents can use existing market power to prevent successful entry by competitors, then a policy based on deregulation will fail. Cable incumbents will not feel pressure to change either pricing or programming practices if they can reliably predict that few consumers will switch to competitors.

The shift in focus to the consumer shows why large incumbent cable companies continue to exercise market power over consumers, programmers, and other related market actors. Briefly, the average cable subscriber finds it too much of a hassle to switch to a competitor. As long as the cable incumbents can reduce the value of competing offerings by control of "high value" programming like regional sports and drive up costs to competitors by controlling the price of new services like video on demand, cable operators can keep the bulk of subscribers from switching. Since the market power to engage in these tactics derives from a combination of existing market share and increased regional and national concentration, incumbent cable operators can stymie effective competition indefinitely.

Without Congressional action to promote competition and reduce the ability of incumbents to exercise market power, cable operators will continue to raise prices above competitive levels and make programming decisions based on affiliation rather than quality.

Defining Market Power

Parties in the "cable wars" frequently use terms that have precise meaning to economists, but very imprecise meaning to non-specialists. Before moving on to the basics, it is therefore useful to define some terms for purpose of this paper. *Market power* means control over so many customers or other valuable resources that the company that has "market power" can tell other people "take my terms or else" and everyone listens. In a monopoly (*i.e.,* where one company controls everything), this is obvious. But it can happen in other markets as well. For example, if one company

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[1] These rules, put in place by Congress in 1992 when cable was clearly a monopoly, prohibit certain anticompetitive practices. Unfortunately, Congress phrased the law in terms of the practices and distribution technology of 1992. In 1992, cable television operators distributed programming via satellite to cable head-ends. As a result, the 1992 Act made programming distributed in such a fashion subject to the program access rules. When technology permitted cable operators to distribute programming, particularly regional programming, terrestrially, the FCC found that the program access rules did not reach terrestrially distributed programming (the "Terrestrial Loophole"). It is also unclear whether new programming, like video on demand, is covered under the existing rules. Finally, unless the FCC takes action before February 2007, even the existing program access rules will end.

controls most of the customers, called *market share,* that company can have market power because everyone wants access to its huge customer base. While market share doesn't always give market power, it helps—particularly where customers have a hard time switching to a competitor.

In 1992, when Congress made a first pass at creating competition in what the FCC calls the multichannel video programming distribution (MVPD) market, Congress concluded that cable's monopoly power at the local level gave it power over customers and that the power to prevent video programmers from reaching customers (foreclosure) gave cable operators power over programmers. Today, however. most people[2] appear to have a choice between several MVPD providers. If that's true, then how does cable retain market power?

The answer lies in the way consumers behave. For many consumers "I'd rather pay than switch" is, in fact, a rational decision even in the face of high prices and better programming on rivals. This consumer behavior lets cable keep customers and gives incumbent cable operators market power over programmers.

Some Basic Cable Competition Math

Why does anyone buy a good or a service? Because they think that what they get, what I will call "value" (or "V") is worth the cost (or "C") of the service. We can write this as a mathematical equation, which makes it easier to understand visually.

Generally, a consumer will buy a service where Value is greater than or equal to Cost, or

$$V_s => C_s$$

Where V_s is the value of the service and C_s is the cost of the service.

So I buy cable when it is worth it for me to have it. Since cable is a subscription service, I theoretically make this calculation every month I don't cancel the service. So, why don't I drop the service when the cable company raises the price? In part, it is because I may discover the service is more valuable when I use it, so I will pay more for it. But it is also because turning off the service may have costs of its own. whether in the form of money costs like a termination fee or the cost of hassle.

But the equation is different when a competing service, like a Direct Broadcast Satellite (DBS) company or overbuilder, is trying to pull a customer away from cable. This introduces something called "switching costs." A "switching cost" is any cost associated with switching from one product to another that is over and above the actual price of the new product. This includes not merely money (for example, a termination fee if I end the contract early), but also the general hassle associated with calling in a new provider, terminating the old system, learning the new system, etc.

Let us assume that V_i is the value of the incumbent service (the one the consumer already uses). C_i is the cost of maintaining that system. V_n is the value of a comparable service. C_n is the cost of the new, comparable service. SW is the switching cost of moving from the old service to the new service.

The Switching Equation:

$$V_i - C_i < V_n - SW - C_n$$

In plain English, it is not enough for the new service to be "as good as" the old one or even just a bit better. Either the new service must be much better, or the cost must be lower, by more than the difference of the switching cost.[3]

This applies universally but doesn't impact most daily buying decisions because the things we buy on a regular basis, like groceries, have little or no switching cost. For example, when I decide to buy a new box of cereal, there is no switching cost if both brands are in my local supermarket because I am out of cereal and need to buy more anyway. My decision about which brand to buy will be determined by cost and whatever value I perceive in the brand I chose (do I want to try something new? Do I perceive one brand as better for me?).

But cable is a subscription service. Unless I move to a new house, switching from cable to a competitive rival has significant non-monetary switching costs to consumers. I need to deal with the cable company to turn off the cable, deal with the

[2] Contrary to the claims of cable operators, not everyone has a choice of competing MVPD provider. Many people lack an unobstructed view of the portion of the southern sky occupied by DBS satellites. In addition, exclusive contracts with landlords prevent many apartment and condo dwellers from using a terrestrial overbuilder. *See* GAO, "Direct Broadcast Satellite Subscribership Has Grown Rapidly But Varies Across Markets" (2005) (GAO 2005).

[3] In theory, a tie will go to the current incumbent because an "indifferent" consumer will simply stay with the existing system. But the average person does not weigh his or her choices in the neat mathematical fashion these equations suggest.

DBS provider, waste a day (at least) waiting for the install, and overcome my fear of learning a new system when I don't know for sure I'll like it better.[4] Statistics from the last few years of cable/DBS competition suggest that consumers are much more sensitive to switching costs and network value than they are to price.[5]

This is the key to market power and competition in video. As a matter of public policy, we want competition to keep down prices, protect consumers from abusive service, and make sure that we have enough diverse news and viewpoints in the media to maintain a healthy democracy. But if competition is an illusion, because we can prove that not enough consumers will switch to make a difference for these things, then policy has to address the issue by making it easier for competitors to get customers.

When Congress passed the 1992 Act, only 60 percent of the country subscribed to cable and the largest cable systems controlled at most a quarter of that number. Cable systems were scattered around the country, minimizing the ability of any single cable system to block a programmer from an entire geographic region. Today, 90 percent of the country subscribes to cable or some other kind of MVPD (mostly DBS). The remaining ten percent has been stable for some time, and is unlikely to sign up with an MVPD in mass numbers anytime soon.

According to the most recent FCC Report on MVPD competition, incumbent cable operators have approximately 70 percent of the total MVPD market (with the five largest providers controlling the bulk of cable subscribers). That means that any competitor must pull new customers away from cable. That would be hard enough, given the problem of overcoming switching cost and consumer uncertainty. But it gets worse for two reasons. First, the national number marks the much higher levels of regional concentration. Not all customers are equal, and clusters of customers in the wealthiest urban areas subscribe to incumbent cable operators,[6] making the level of regional concentration in areas dominated by large cable companies much more concentrated than the 70 percent national figure. Because a few large cable companies dominate these regions, these cable companies still have market power. Using the market power of their existing subscribers, they can take steps to make it much harder for these customers to switch to competitors and can therefore raise prices, deny programming to rivals, and favor affiliated programming over unaffiliated programming.

Implications for Pricing

Recall the Switching Equation:

$$V_i - C_i < V_n - SW - C_n$$

We can now explain why cable can keep raising the subscription price even in the presence of a competitor. The "SW" provides a cushion. The cable operator can raise C_n to just about C_i+SW, unless a competitor offers a high enough V_n. At the same time, the cable companies can use their market power to increase the cost to the competitor or lower the value of their competing network in ways described below. So the competitor either can't raise V_n enough to justify the added expense of the switching cost, or drop C_n enough to compensate for switching cost, to attract a lot of new customers.[7]

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[4] Some of these apply even if I am moving to a new house.

[5] *See, e.g.*, Andrew S. Wise and Kiran Duwadi, "Competition Between Cable Television and Direct Broadcast Satellite—It's More Complicated Than You Think," FCC Media Bureau Staff Research Paper (2005) ("Wise & Duwadi 2005"); GAO 2005. The issue of "hassle" as a switching cost for consumers, and the need to impose a regulatory solution to encourage effective competition, is well established in telecommunications markets. For example, to make competition a reality in the competing telephone market and cell phone market. Congress and the FCC created rules to let consumers move phone numbers from one service to another. Why? Because switching phone numbers was such a hassle to consumers that if they had to change numbers to switch, not enough of them would do so to bring about the benefits of competition.

[6] GAO 2005 (observing lowest penetration of DBS in urban areas).

[7] The empirical data in GAO 2005 is generally confirmatory. GAO 2005 reported that an increase in incumbent cable capacity (offering more channels) or offering additional services such as VoD or broadband (all of which increase V_i) reduce DBS penetration. Similarly, denial of local programming to DBS (reducing V_n) significantly impacts competitor penetration. *See also* Wise & Duwadi (2005) (finding that DBS demand is suppressed when DBS denied regional sports programming). When considering the implications for policy, it is important to remember these are aggregate trends. The specific values, and therefore specific responses, change for each consumer. DBS can attract some customers by offering steep discounts and free equipment (cutting Cn), free installation (cutting SW), or free TiVo (increasing V_n). But, because of the way cable can exercise market power, it can keep DBS costs sufficiently high and network value sufficiently low to avoid losing a critical mass of customers.

Positive and Anticompetitive Responses By Cable To Competition

Cable operators generally have not responded to DBS competition with price cuts (in fact, they have raised prices faster than inflation for the last five years)[8] Instead, incumbent cable operators have worked to increase the value of its network (the good response to competition) and have leveraged market power to suppress the value of rival MVPDs or drive up costs to rivals (the anti-competitive or "bad" response). For example, cable operators have increased the value of their package by expanding capacity and introducing additional services, such as video on demand (VoD) and broadband. At the same time, DBS providers like DIRECTV respond by offering free TiVo service (increasing their own V_n), offering free equipment (decreasing C_n) and offering free installation (decreasing SW). Terrestrial overbuilders respond by offering a combination of video, voice and broadband for a "triple play" service. These are the positive effects competition policy should encourage.

At the same time, however, cable operators leverage their market power to reduce the value of new competitors, artificially suppressing V_n. Withholding regional sports network programming is one example of decreasing V_n. Another method is to raise costs to the competitor, artificially inflating C_n. For example, the cable owners of the iN Demand VoD service charge DBS four times as much for programming as they charge other incumbent cable systems. DBS can either not offer the service (reducing V_n) or offer the service and eat the additional cost (since they must keep C_n low to compensate for switching costs).

Lack of Information and Uncertainty

In addition to switching costs, lack of information and uncertainty will prevent a number of consumers from switching. A new user has no idea whether he or she will actually like a competitor better, or how much hassle is involved in switching. This uncertainty and lack of information will cause the consumer to devalue the competing network and exaggerate the switching costs.[9] The more "risk averse" the consumer, the more impact uncertainty and lack of information has on how the consumer assesses value and makes a choice. The most optimistic (or "risk indifferent") will assign the highest potential value to the new system and the lowest value to the switching costs. The most risk averse consumers will assign the minimum value to the competing network and the maximum value to the switching costs. Where folks fall on this scale determines when they switch from one system to another.

Again, it is important to recognize that a cable operator does not need to keep *every* customer to maintain market power. It only needs to keep *enough* customers to maintain market power. In fact, a strategic thinking cable operator will want enough competition in the market to prevent an unavoidable appearance of monopoly and resultant regulation, but not enough to pose a competitive risk.[10] As long as cable operators can consolidate regionally and nationally to keep control of sufficient numbers of high value customers, slight changes in the overall national numbers for MVPDs won't make much difference on real market power.

The cable strategies of increasing their own value while diminishing the value of competitors thus complement each other synergistically. Although consumers can easily evaluate price, lack of information or experience makes it hard to judge other kinds of value. When DBS offered 200 channels and cable systems only offered 30, the value difference for DBS looked more impressive than if DBS offers 200 channels and cable offers 125 channels.[11] Again, it is important to stress that, as with

[8] They have responded to terrestrial competitors with price cuts, suggesting that consumer uncertainty diminishes when the service "looks the same," making comparisons easier and consumers more likely to switch. At the same time, they have also been more vigorous in using regional market power to disadvantage terrestrial overbuilders. *See* GAO, "Wire-based Competition Benefitted Consumers in Selected Markets (2004). The differences in the nature of competition from different competitors goes beyond the scope of this paper. Given the state of competition in the video marketplace, however, in which incumbent cable operators continue to control the overwhelming share of the market and where DBS is the most significant competitor by national market share, the differences are not important for the basic competition math.

[9] We could therefore tweak our equation to reflect this, as $V_i - C_i < (V_n/U) - (SW*U) - (C_n*U)$, where "U" represents the uncertainty caused by a combination of less than perfect information and risk aversion. But that starts to get too complicated. It's enough to say that the less information a customer has, and the less certain they are about the network value, the less they will value the competitor's network and the more they will worry about switching costs and actual costs.

[10] For example, in 1997, Microsoft rescued its long-term rival, Apple, from possible bankruptcy by investing $150 million.

[11] The fact that most viewers only reliably watch a fraction of the number of available channels also leads consumers to devalue additional capacity. If I can't find more than five good channels with 125 channels on cable, why do I think adding 75 more channels will help?

the ability to raise price, the switching cost provides a cushion on how much a cable operator must improve service. The cable operator does not have to make $V_i=V_n$. It is enough that $V_i>=V_n-SW$. So 125 channels is "close enough," especially when the uncertainty about the value of the new networks makes the customer assign it an artificially low value. ("Is getting Current really worth switching to DIRECTV? Nah, it can't be that good . . . ")

Impact on Programming[12]

The Switching Equation and information problems allow cable operators to control the access of independent programmers to the home. Cable operators claim that if they consistently favored programming for reasons other than quality, such as to force an independent to give the cable operator an ownership interest,[13] the cable operators would lose customers to competitors with better programming. But the incumbent doesn't need the "best" programming because the incumbent doesn't need to maximize the value of its network. The switching cost provides a cushion. As long as programming remains "good enough," the switching cost will keep the subscriber from following the "better" programming to a competitor.

New independent programmers also have a serious information problem that makes the threat that subscribers will "chase it" to a rival almost non-existent. Let's say programming denied by the incumbent is absolutely wonderful. The incumbent viewer is never going to see it, because it is on the other system. Rival programming channels, oddly enough, are unlikely to take advertising to help viewers discover programming better than their own (unless, of course, the two networks are owned by a single owner, an increasingly common event). How is the incumbent viewer going to acquire an appreciation of the high value for the "superior" programming network if he or she never sees it? Given that the incremental value of anew network to any viewer is likely to be fairly low,[14] it is rather far fetched that the incumbent cable operator will seriously fear that denying carriage to independents will cost so many subscribers as to overcome the other economic advantages of favoring affiliated programming. Or, more bluntly, as long as the cable operator programming doesn't stink so badly it actively drives viewers away. the cable operator can safely ignore new independents.

Regional Sports Programming and "Marquee" Programming

The argument that the incremental value of programming gives programmers no leverage is not universally true. Some programming is more "high value" than others. In general, local broadcast stations and some well established cable networks, like ESPN or CNN, are so valuable that any MVPD that wants to compete needs to have it. Such high value programming also raises the question of *substitutability*. If I can't have a specific network, is another similar network an acceptable substitute for consumers?

The answer is, sometimes "yes" and sometimes "no." Some consumers will be happy with any 24/7 news channel. But someone who values the perspectives and opinions of FOX News will not readily accept the BBC World Report or CNN instead because they are both "news," and certainly will not accept Comedy Central's "Daily Show" as a substitute even though both are "video programing,"[15] In economic terms, the person that regards CNN and FOX News as equally acceptable regards them as *close substitutes*. The person that grudgingly accepts CNN over FOX News if he or she has no choice regards them as *substitutes*, but not *close* substitutes.

[12] To keep things simple, I'm not going to talk about how local broadcasters and broadcasting networks like CBS enter the equation. The American Cable Association has recently (January 30, 2006) released a study addressing this issue. For purposes of this paper, it is sufficient to note that the presence of broadcast networks and local broadcasters in the equation does not work to the advantage of cable competitors.

[13] This is an illegal practice alleged to be widespread in the cable industry. The cable industry denies it has market power to force such "equity concessions" as a "price" of carriage.

[14] "Incremental value" means how much does this one change make a difference in overall value of the service. For some programming this may be very high, but for most, it is pretty low.

[15] This should also explain why Blockbuster, video iPods, and free TV are not competitors to cable, as sometimes argued. The value proposition between a system that provides hundreds of channels of news and entertainment on a dynamic 24/7 basis, as opposed to the value proposition of a service that merely rents movies and games (or stores them for future play), is so different that no consumer would ever consider them substitutes. Similarly, because free TV is offered as part of the cable package, its value is completely captured in the cable package. It does not "compete" in any usual sense of the word. Rather, it is a question of whether the added value is worth the cost. For the 10 percent of television homes that do not subscribe to cable or other pay service, the answer appears to be "no."

Needless to say, not being able to get the programming you want on the competing system, even if it is a "substitute," diminishes the value of the competing network.[16]

Which gets us back to sports. Cable likes to argue that ESPN (which is owned by Disney, not a cable company) and things like NFL Sunday Ticket (a football package on DIRECTV) neutralize any advantage cable operators get from withholding regional sports networks or other local programming. After all, sports is sports, right?

As a simple experiment, ask any Red Sox[17] fan if he or she thinks watching the Cleveland Cavaliers play the Los Angeles Lakers[18] is "the same" as watching the Red Sox play the Yankees because they are both "sports games." Then ask if watching the Chicago Cubs play the St. Louis Cardinals[19] is "the same." Ask if the Red Sox fan will give up watching Red Sox games in exchange for all the football he or she can watch, including the New England Patriots.[20]

Any Red Sox fan reading this knows the answer. Watching generic "sports," or even another baseball team with a romantic "curse" doesn't cut it when the Red Sox are playing the Yankees. There are plenty of sports fans who like to watch "generic sports"; that's why ESPN is such a popular network. But just because someone likes to watch generic sports doesn't make it a substitute for a local team. For many people, local sports and "generic sports" are not even substitutes, never mind close substitutes.

Worse, the demand for popular local sports teams varies. I might only watch the Red Sox when they play the Yankees or when they make it to the playoffs. But when I want to watch them, I *really* want to watch them. If I have to give up watching local sports to switch, that looks like a huge loss of value to me, even if I only actually watch games not carried on broadcast television (and retransmitted on the competitor) a few times a year. Because many people appear to assign a huge value to this loss of unique programming, denial of regional sports programming seriously devalues the competing network despite the presence of other "generic" sports packages.

Cable Replies

Generally, cable operators argue that government regulation is "bad" and "picks winners." By contrast, they maintain, deregulation creates "an open market" that is "competition driven." Finally, cable operators they need "a level playing field" to compete "fairly" with would-be competitors.

The "level playing field" is a myth. Cable did not achieve its current market share, and therefore its existing level of market power, by winning any "fair fights" in an "open, competitive market." It got them because the government made cable a virtual monopoly in 1984 when it passed the first Cable Act. Congress tried to correct the damage in 1992, then changed the rules back to "fair" in 1996. As a result, any new entrant is already running uphill. If the government lets cable companies slap on a pair of leg-irons by refusing to regulate anti-competitive behavior, competition becomes impossible.

The second argument cable operators make is that they invested lots of money in upgrading their systems, so they should be allowed to get a return on investment. I agree. But, like the rest of us, cable operators need to work for a living rather than just leverage their market power. If I buy a shotgun in the expectation I can rob my neighbors, I am not entitled to a "return on investment." If I build a cable network in the expectation I can use it to deny regional programming to my competitors so I will be able to charge monopoly-level prices to my subscribers, I'm not entitled to a monopoly-level "return on investment."

Policy Recommendations

Policy must address the market reality. A preference for competition over regulation may be a valid starting point for consideration, but where competition does not emerge, or can be predicted not to emerge, Congress and regulators must step in to take action.

As a Nation, we depend on the widespread availability of affordable video distribution. The Supreme Court has said that ensuring to the people of the United States a video distribution system that provides needed news and diverse views to

[16] *See generally* Wise & Duwadi (2005) (attempting to break out numerous factors with regard to competition in MVPD markets, including programming preferences).
[17] A baseball team in Boston. They have a longstanding rivalry with the New York Yankees.
[18] Basketball teams.
[19] Both baseball teams. Like the Red Sox, the Cubs have a devoted following despite consistently losing.
[20] A football team popular in Boston.

all Americans as "a government purpose of the highest order." [21] If Congress intends to rely upon competition to ensure that the Nation's video distribution systems are affordable and provide innovative and informative programming reflecting the diversity of our citizenry, then it must craft policies that genuinely promote competition in the MVPD market.

This paper provides a suitable framework for addressing regulation to promote competition. In analyzing the existing MVPD market, policymakers should consider policies that make competition viable by limiting the power of incumbent cable operators to manipulate the value of a competitor's offering, drive up the cost of a competitor's offering, or increase the switching cost to a subscriber from a cable network to a rival network. These policies should include, at the least, limits on regional and national concentration by cable incumbents (reducing market power directly) and enhanced program access rules (extending existing rules beyond the February 2007 deadline and including both terrestrially distributed programming (such as regional sports) and new "non-linear" programming services (such as video on demand).

In making these assessments, Congress and the FCC should reject simplistic arguments about "deregulation" and "level playing fields." Unless subscribers can switch from one service to another with reasonable ease, the expected benefits of competition—lower prices, innovation, and diverse high-quality programming—simply will not emerge.

PREPARED STATEMENT OF JOHN GOODMAN, PRESIDENT, COALITION FOR COMPETITIVE ACCESS TO CONTENT (CA2C)

The Coalition for Competitive Access to Content (CA2C) submits three documents as reference to its position regarding assured access to content for all current and future competitors regardless of the technology used or network ownership.

The current program access rules have been successful and essential for the development of satellite (DBS) and other new competitors that resulted from the Telecommunications Act of 1996. The development of new and expanded competition is still a primary goal of Congress. However, the current rules have been outdated by massive technology changes and continuing structural changes within the industry. Despite these changes, assured access to content is still a necessary foundation for the development of distribution competition that will expand services and bring better choice to consumers.

Since their inception in 1992, both the FCC and Congress have consistently endorsed the need for these rules. The FCC extended the current rules in 2002, and has also imposed conditions that assure program access as part of merger or acquisition proceedings. The FCC has also determined, however, that new legislation is needed for it to go beyond satellite delivered content that is also subject to vertical integration. In addition, the current program access rules are scheduled to sunset in 2007.

The CA2C has developed specific policy proposals to address these program access issues. A copy of this proposed legislation is attached. The CA2C firmly believes that Congress should update the current rules as an essential part of telecom reform that is currently being pursued. The CA2C has reviewed these documents with both committee and member staff and look forward to our continuing discussions about this vital policy issue.

Current members of the CA2C include: AT&T (formerly SBC), BellSouth, BPLIA, BSPA, EchoStar, ITTA, Media Access Project, OPASTCO, RCN, US Telecom, and Verizon.

PRESERVE CONGRESSIONAL INTENT TO PROMOTE VIEWER CHOICE

Access to Video Content Is Necessary for Effective Competition

The world of telecommunications is rapidly changing. The advent of cable brought new competition to the broadcast networks and new choices for the American viewing public. Digital Broadcast Satellite (DBS) did the same. Now, broadband is bringing more competition and more choices. At each stage, new competitors have depended on access to programming—without access to the content that subscribers want, competitive entry is foreclosed and the viewing public is left with fewer choices and higher prices.

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[21] *Turner Broadcasting System, Inc*. v. *FCC*, 512 U.S. 622 (1997).

Congress Intended a Level Playing Field

In 1992, Congress recognized that the cable industry could use its control over access to video programming to stifle competition. To prevent this, and to ensure a level playing field, Congress prohibited vertically-integrated cable companies—those that have ownership interests in programming networks—from refusing to make their content available to competitive multichannel video programming distributors (e.g. DBS and non-incumbent cable companies). As a technical matter, Congress tied this prohibition to how cable companies received cable programming at the time—satellite feeds from video programmers to "head-ends" around the country. The legislative vehicle for this requirement was the Cable Act of 1992, in which Congress added Section 628 of the Communications Act of 1934 (47 U.S.C. § 548).

Technological Advances Have Opened a Loophole

Today, satellite transmission is no longer the only method of transmitting programming to the head-end. Fiber-based terrestrial networks have become economical alternatives, particularly for regional sports and news programming controlled by regionally clustered cable operators. The current version of Section 628 did not foresee these developments, so vertically-integrated cable companies which distribute their programming terrestrially are not covered by the legislation. These cable companies have already demonstrated their willingness to make use of this loophole to freeze out competition—the industry vigorously fought reauthorization of Section 628 in its current form in 2002.

Update Section 628, Close the Loophole, and Restore Congressional Intent

Section 628 protection was key to the development of satellite-based competition like DIRECTV and EchoStar. It also supplied the necessary foundation for early broadband development, allowing [satellite- and ground-based] broadband service providers to offer bundles of voice, video, and high-speed data/Internet services directly to homes and small businesses across the country. Updating Section 628 to account for non-satellite methods of program distribution will close the loophole opened by advancing technology, restore Congressional intent, and preserve competition in the delivery of video services.

COALITION FOR COMPETITIVE ACCESS TO CONTENT (CA2C) BACKGROUND AND SUMMARY OVERVIEW

Coalition for Competitive Access to Content (CA2C)

The CA2C has been organized as a very broad-based Ad Hoc Coalition to pursue legislation assuring fair access to content. The current members of the coalition include the AT&T (formerly SBC), BellSouth, BPLIA, BSPA, EchoStar, ITTA, Media Access Project, OPASTCO, RCN, US Telecom, and Verizon. Many other businesses and organizations are expected to join the CA2C in support of content access legislation. Other parties that have expressed support for content access legislation include ACA, Consumers Union, and NATOA. The support for content access legislation is expected to include all the major parties that lobbied to extend the sunset of the current program access rules in 2002, and others who have developed an interest in the issue since that time.

The CA2C believes that assured fair access to content is one of the most vital strategic policy issues that must be addressed in new telecom legislation. New competing networks must have fair access to the content their potential subscribers want or they will fail. The vertical integration of major MSOs into content ownership continues to expand and the ability to use this vertical integration to foreclose access to content stands as a growing and unique threat to the success of competitive entry. The current legislation related to content access has been historically effective but the existing language has narrow application to satellite delivered content that does not relate to today's new technology and the current rules are scheduled to sunset. The CA2C believes that new legislation is needed to address program access issues regardless of which distribution technology is used by competing networks.

Legislative Background

In 1992, Congress recognized that the cable industry could use its control over access to video programming to stifle competition and it enacted as part of the 1992 Cable Act [1] the statutory prohibition on exclusive cable distribution of vertically in-

[1] Cable Television Consumer Protection and Competition Act of 1992, Pub. L. No. 102–385, 106 Stat. 1460 (1992) (1992 Cable Act).

tegrated programming and other discriminatory conduct involving access to programming—Section 628 of the Communications Act of 1934, as amended.[2] In doing so, Congress recognized that "vertically integrated program suppliers have the incentive and ability to favor their affiliated cable operators over other multichannel programming distributors using other technologies."[3] Representative Billy Tauzin, one of the principal architects of the 1992 Cable Act has recalled that, in 1992:

> [Congress] awakened to the sad realization that we had forgot one crucial element, and that was *cable controlled programming*. And that *controlling programming was a way of making sure that there would be no competitors*. If a competitor couldn't get the programming, it certainly wasn't going to launch the [system].[4]

Through Section 628, Congress sought to break the cable industry's unique leverage over programming, which had historically been exercised through exclusivity arrangements and other market power abuses exercised by cable operators and their affiliated programming suppliers. These anticompetitive practices denied programming to competitive technologies, or made programming available on discriminatory terms and conditions.[5] Section 628 contains the general provision that:

> It shall be unlawful for a cable operator, a satellite cable programming vendor in which a cable operator has an attributable interest, or a satellite broadcast programming vendor to engage in unfair methods of competition or unfair or deceptive acts or practices, the purpose or effect of which is to hinder significantly or to prevent any multichannel video programming distributor from providing satellite cable programming or satellite broadcast programming to subscribers or consumers.[6]

Congress, through Section 628, also directed the FCC to adopt rules to "address and resolve the problems of unreasonable cable industry practices, including restricting the availability of programming and charging discriminatory prices to noncable technologies" and provided further specific guidance.[7] Section 628(b)(2) requires such rules to prohibit, among other things, discriminatory treatment by programmers in which a cable operator has an attributable interest between such cable operator and unaffiliated competitors. Section 628(b)(2)(D) specifically required the FCC to prohibit exclusive contracts between cable operators and cable programmers in which such operators have an attributable interest.

The current 628 rules were scheduled to sunset in 2002. Many members of the CA2C successfully lobbied for extension of the current rules. The FCC concluded on June 28, 2002, in the *Program Exclusivity Prohibition Extension Order*, that the prohibition on program exclusivity should be extended for at least another five years.[8] In that order, the FCC found that "access to vertically integrated programming continues to be necessary in order for [competitive] MVPDs [multichannel video programming distributors] to remain viable in the marketplace"[9] and that [f]ailure to secure even a portion of vertically integrated programming would put a nonaffiliated cable operator or competitive MVPD at a significant disadvantage vis-a-vis a com-

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[2] 47 U.S.C. § 548.

[3] 1992 Cable Act, at § 2(a)(5).

[4] *Examination of Cable Rates: Hearing Before the Senate Commerce, Science, and Transportation Comm.*, 105th Cong. (July 28, 1998) (statement of Rep. Billy Tauzin) (emphasis added).

[5] *See* 138 Cong. Rec. H6540 (daily ed. July 23, 1992) (Rep. Eckart) (cable operators "know that if they maintain their stranglehold on this programming, they can shut down competition—even the deep pockets of the telephone companies for a decade or more."); 138 Cong. Rec. H6533–34 (daily ed. July 23, 1992) (statement of Rep. Tauzin) ("[My] amendment, very simply put, requires the cable monopoly to stop refusing to deal, to stop refusing to sell its products to other distributors of television programs. In effect, this bill says to the cable industry, 'You have to stop what you have been doing, and that is killing off your competition by denying it products' . . . Programming is the key . . . Without programming, competitors of cable are . . . stymied . . . What does it mean? It means that cable is jacking the price up on its competitors so high that they can never get off the ground. *In some cases they deny programs completely to those competitors to make sure they cannot sell a full package of services. So the hot shows are controlled by cable* . . . It is this simple. There are only five big cable integrated companies that control it all. My amendment says to those big five, 'You cannot refuse to deal anymore.'") (emphasis added).

[6] 47 U.S.C. § 548(b).

[7] H.R. Conf. Rep. No. 102–862, at 93 (1992), *reprinted in* 1992 U.S.C.C.A.N. 1231, 1275.

[8] *Implementation of the Cable Television Consumer Protection and Competition Act of 1992, Development of Competition and Diversity in Video Programming Distribution: Section 628(c)(5) of the Communications Act, Sunset of the Exclusive Contract Prohibition, Report and Order*, 17 FCC Rcd 12124 (2002) ("*Program Exclusivity Prohibition Extension Order*").

[9] *Id.* at 12138.

petitor with access to such programming."[10] The FCC also observed that "vertically integrated programmers generally retain the incentive and ability to favor their cable affiliates over nonaffiliated cable operators and other competitive MVPDs to such a degree that, in the absence of the prohibition [on exclusive contracts with affiliates], competition and diversity in the distribution of video programming would not be preserved and protected."[11] Further, the FCC found, "[d]espite the progress that has been made in the 10 years since the enactment of the 1992 Act, a considerable amount of vertically integrated programming in the marketplace today remains "must-have" programming to most MVPD subscribers," and that "if [competitive MVPDs] were to be deprived of only some of this "must-have" programming, their ability to retain subscribers would be jeopardized."[12]

Section 628 protection was essential for the development of Satellite based competition and it was a necessary foundation for the early development of BSPs and other new competition. However, new technology has no protection under the limited and specific language of the existing statute as it specifically applies to satellite delivered content. Terrestrial distribution has emerged as a preferred and pervasive alternative to satellite based distribution. Local sports and news content that is not delivered by satellite has grown in importance. Section 628 also has no application to any form of IP technologies used to deliver video or other content to PCs, TVs or other end use appliances. The CA2C members believe that the same basic market conditions that existed in 1992 exist today but they relate to a broader range of competing technologies and a stronger market position of vertical integration and likely abuse if allowed.

SECTION 628 [47 U.S.C. SECTION 548]. DEVELOPMENT OF COMPETITION AND DIVERSITY IN VIDEO PROGRAMMING DISTRIBUTION

(a) Purpose.—The purpose of this section is to promote the public interest, convenience, and necessity by increasing competition and diversity in the multichannel video programming market, to increase the availability of MVPD programming and satellite broadcast programming to persons in rural and other areas not currently able to receive such programming, and to spur the development of communications technologies.

(b) Prohibition.—It shall be unlawful for an MVPD, an MVPD programming vendor in which an MVPD has an attributable interest, or a satellite broadcast programming vendor to engage in unfair methods of competition or unfair or deceptive acts or practices, the purpose or effect of which is to hinder significantly or to prevent any MVPD from providing MVPD programming or satellite broadcast programming to subscribers or consumers.

(c) Regulations required.—

(1) Proceeding required.—Within 180 days after the date of enactment of this section, the Commission shall, in order to promote the public interest, convenience, and necessity by increasing competition and diversity in the multichannel video programming market and the continuing development of communications technologies, prescribe regulations to specify particular conduct that is prohibited by subsection (b).

(2) Minimum contents of regulations.—The regulations to be promulgated under this section shall—

(A) establish effective safeguards to prevent an MVPD which has an attributable interest in an MVPD programming vendor or a satellite broadcast programming vendor from unduly or improperly influencing the decision of such vendor to sell, or the prices, terms, and conditions of sale of, MVPD programming or satellite broadcast programming to any unaffiliated MVPD;

(B) prohibit discrimination by an MVPD programming vendor in which an MVPD has an attributable interest or by a satellite broadcast programming vendor in the prices, terms, and conditions of sale or delivery of MVPD programming or satellite broadcast programming among or between cable systems, cable operators, or other MVPDs, or their agents or buying groups; except that such an MVPD programming vendor in which an MVPD has an attributable interest or such a satellite broadcast programming vendor shall not be prohibited from—

[10] *Id.*
[11] *Id.* at 12125.
[12] *Id.* at 12139.

(i) imposing reasonable requirements for creditworthiness, offering of service, and financial stability and standards regarding character and technical quality;

(ii) establishing different prices, terms, and conditions to take into account actual and reasonable differences in the cost of creation, sale, delivery, or transmission of MVPD programming or satellite broadcast programming;

(iii) establishing different prices, terms, and conditions which take into account economies of scale, cost savings, or other direct and legitimate economic benefits reasonably attributable to the number of subscribers served by the distributor; or

(iv) entering into an exclusive contract that is permitted under subparagraph (D);

(C) prohibit practices, understandings, arrangements, and activities, including exclusive contracts for MVPD programming or satellite broadcast programming between an MVPD and an MVPD programming vendor or satellite broadcast programming vendor, that prevent an MVPD from obtaining such programming from any MVPD programming vendor in which an MVPD has an attributable interest or any satellite broadcast programming vendor in which an MVPD has an attributable interest for distribution to persons in areas not served by an MVPD as of the date of enactment of this section; and

(D) with respect to distribution to persons in areas served by an MVPD, prohibit exclusive contracts for MVPD programming or satellite broadcast programming between an MVPD and an MVPD programming vendor in which an MVPD has an attributable interest or a satellite broadcast programming vendor in which an MVPD has an attributable interest, unless the Commission determines (in accordance with paragraph (4)) that such contract is in the public interest.

(3) Limitations.—

(A) Geographic limitations.—Nothing in this section shall require any person who is engaged in the national or regional distribution of video programming to make such programming available in any geographic area beyond which such programming has been authorized or licensed for distribution.

(B) Applicability to satellite retransmissions.—Nothing in this section shall apply (i) to the signal of any broadcast affiliate of a national television network or other television signal that is retransmitted by satellite but that is not satellite broadcast programming, or (ii) to any internal satellite communication of any broadcast network or cable network that is not satellite broadcast programming.

(C) Exclusion of Individual Video Programs. Nothing in this section shall apply to a specific individual video program produced by an MVPD for local distribution by that MVPD and not made available directly or indirectly to unaffiliated MVPDs, provided that: (i) all other video programming carried on a programming channel or network on which the individual video program is carried, is made available to unaffiliated MVPDs pursuant to subsection (c)(2)(D), and (ii) such specific individual video program is not the transmission of a sporting event.

(D) MVPD sports programming. The prohibition set forth in Section 628(c)(2)(D), and the Commission's rules adopted pursuant to that section, shall apply to any MVPD programming that includes the transmission of live sporting events, irrespective of whether an MVPD has an attributable interest in the MVPD programming vendor engaged in the production, creation, or wholesale distribution of such MVPD programming.

(4) Public interest determinations on exclusive contracts.—In determining whether an exclusive contract is in the public interest for purposes of paragraph (2)(D), the Commission shall consider each of the following factors with respect to the effect of such contract on the distribution of video programming in areas that are served by an MVPD;

(A) the effect of such exclusive contract on the development of competition in local and national multichannel video programming distribution markets;

(B) the effect of such exclusive contract on competition from multichannel video programming distribution technologies other than cable;

(C) the effect of such exclusive contract on the attraction of capital investment in the production and distribution of new MVPD programming;

(D) the effect of such exclusive contract on diversity of programming in the multichannel video programming distribution market; and

(E) the duration of the exclusive contract.

(5) Sunset provision.—The prohibition required by paragraph (2)(D) shall cease to be effective 10 years after the date of enactment of this section, unless the Commission finds, in a proceeding conducted during the last year of such 10-year period, that such prohibition continues to be necessary to preserve and protect competition and diversity in the distribution of video programming.

(d) Adjudicatory proceeding.—Any MVPD aggrieved by conduct that it alleges constitutes a violation of subsection (b), or the regulations of the Commission under subsection (c), may commence an adjudicatory proceeding at the Commission. The Commission shall request from a party, and the party shall produce, such agreements between the party and a third party relating to the distribution of MVPD programming that the Commission believes to be relevant to its decision regarding the matters at issue in such adjudicatory proceeding. The production of any such agreement and its use in a Commission decision in the adjudicatory proceeding shall be subject to such provisions ensuring confidentiality as the Commission may by regulation determine.

(e) Remedies for violations.—

(1) Remedies authorized.—Upon completion of such adjudicatory proceeding, the Commission shall have the power to order appropriate remedies, including, if necessary, the power to establish prices, terms, and conditions of sale of programming to the aggrieved MVPD.

(2) Additional remedies.—The remedies provided in paragraph (1) are in addition to and not in lieu of the remedies available under Title V or any other provision of this Act.

(f) Procedures.—The Commission shall prescribe regulations to implement this section. The Commission's regulations shall—

(1) provide for an expedited review of any complaints made pursuant to this section, including the issuance of a final order terminating such review within 120 days after the date on which the complaint was filed;

(2) establish procedures for the Commission to collect such data, including the right to obtain copies of all contracts and documents reflecting arrangements and understandings alleged to violate this section, as the Commission requires to carry out this section; and

(3) provide for penalties to be assessed against any person filing a frivolous complaint pursuant to this section.

(g) Reports.—The Commission shall, beginning not later than 18 months after promulgation of the regulations required by subsection (c), annually report to Congress on the status of competition in the market for the delivery of video programming.

(h) Exemptions for prior contracts.—

(1) In general.—Nothing in this section shall affect any contract that grants exclusive distribution rights to any person with respect to satellite cable programming and that was entered into on or before June 1, 1990 or any contract that grants exclusive distribution rights to any person with respect to MVPD programming that is not satellite cable programming and that was entered into on or before July 1, 2003, except that the provisions of subsection (c)(2)(C) shall apply for distribution to persons in areas not served by an MVPD.

(2) Limitation on renewals.—A contract pertaining to satellite cable programming or satellite broadcast programming that was entered into on or before June 1, 1990, but that is renewed or extended after the date of enactment of this section shall not be exempt under paragraph (1). A contract pertaining to MVPD programming that is not satellite cable programming that was entered into on or before July 1, 2003, but that is renewed or extended after the date of enactment of this provision shall not be exempt under paragraph (1).

(i) Definitions.—As used in this section:

(1) The term "satellite cable programming" has the meaning provided under Section 705 of this Act, except that such term does not include satellite broadcast programming.

(2) The term "satellite cable programming vendor" means a person engaged in the production, creation, or wholesale distribution for sale of satellite cable programming, but does not include a satellite broadcast programming vendor.

(3) The term "satellite broadcast programming" means broadcast video programming when such programming is retransmitted by satellite and the entity retransmitting such programming is not the broadcaster or an entity performing such retransmission on behalf of and with the specific consent of the broadcaster.

(4) The term "satellite broadcast programming vendor" means a fixed service satellite carrier that provides service pursuant to Section 119 of Title 17, United States Code, with respect to satellite broadcast programming.

(5) The term "MVPD programming" means:

(A) Video programming primarily intended for the direct receipt by MVPDs for their retransmission to MVPD subscribers (including any ancillary data transmission); and

(B) Additional types of programming content that the Commission determines in a rulemaking proceeding to be completed within 120 days from enactment of this provision is, as of the time of such rulemaking, of a type that is primarily intended for the direct receipt by MVPDs for their retransmission to MVPD subscribers, regardless of whether such programming content is digital or analog, compressed or uncompressed, encrypted or unencrypted, provided on a serial, pay-per-view, or on demand basis, and without regard to the end-user device used to access such programming or the mode of delivery of such programming content to MVPDs; provided that in evaluating the additional types of programming content to be included within this definition, the Commission shall consider the effect of technologies and services that combine different forms of content so that certain content or programming is not included within the foregoing definition solely because it is integrated with other content that is of a type that is primarily intended for the direct receipt by MVPDs for their retransmission to MVPD subscribers.

(C) Any interested MVPD or MVPD programming vendor may petition the Commission to modify the additional types of programming content included by the Commission within the definition of MVPD programming in light of the purpose of this section, market conditions at the time of such petition, and the factors to be considered by the Commission under subsection (i)(5)(B).

(6) The term "MVPD programming vendor" means a person engaged in the production, creation, or wholesale distribution for sale of MVPD programming, but does not include a satellite broadcast programming vendor.

(7) The term "MVPD" shall mean multichannel video programming distributor.

(j) Common Carriers.—Any provision that applies to an MVPD under this section shall apply to a common carrier or its affiliate that provides video programming by any means directly to subscribers. Any such provision that applies to an MVPD programming vendor in which an MVPD has an attributable interest shall apply to any MVPD programming vendor in which such common carrier has an attributable interest. For the purposes of this subsection, two or fewer common officers or directors shall not by itself establish an attributable interest by a common carrier in an MVPD programming vendor (or its parent company).

[Uncodified provision: Within 180 days after the date of enactment of this provision, the Commission shall prescribe such regulations as may be necessary to implement the amendments to this section made by such Act.]

DAKOTA CENTRAL COMMUNICATIONS
January 30, 2006

Hon. TED STEVENS,
Chairman,
Hon. DANIEL K. INOUYE,
Co-Chairman,

Senate Committee on Commerce, Science, and Transportation,
Washington, DC.

Dear Senators Stevens and Inouye:

I am the General Manager of Dakota Central Telecommunications Cooperative located in Carrington, North Dakota. I would like to submit a few comments in regard to the hearing you are holding January 31, 2006 concerning video content. In addition, I would like to thank Senator Dorgan for his assistance in allowing us to submit these comments as well as thank Senators Stevens and Inouye for the opportunity.

Dakota Central is a small progressive cooperative that provides telephone, high-speed broadband and video services to its customers through a number of transmission mediums including copper, fiber and wireless technologies. As a result of the RUS Broadband Loan Program, Dakota Central was able to construct, over the past two years, a Fiber-to-the-Home (FTTH) network in a nearby community that was lacking in broadband access.

Since the FTTH technology has very large bandwidth capabilities, we were also able to provide video over the network and incorporated this service into our business plan. Although the FTTH technology incorporates video rather seamlessly, there have been many obstacles to overcome unrelated to the technology utilized.

In our situation, most of the issues revolve either around the cost or the ability to acquire the video programming content. The cost of the video content is the largest single expense we incur to provide video service. It consumes in excess of 55 percent of the retail amount we charge for the service. In 2006, our video programming costs overall are increasing over 9 percent from the previous year with some of the content providers raising their individual rates 20 percent. These large rates increases are not just a one time occurrence but have been occurring annually for a number of years throughout the marketplace. These huge increases seem to be excessive when inflation has been running less than 3 percent during these same periods.

As a small video provider, we have very little leverage to obtain lower rates and believe the large incumbent cable operators receive significant discounts from the rates we are charged. To make matters worse, many of the video content providers offer suites of channels and in order to obtain their best rates, it is necessary to subscribe to channels that our customers may have no desire to view. Ultimately, the end user customer ends up paying more as a result of the tying arrangements.

As a result of deploying a FTTH network, we are able to offer a multitude of channels to our customers without exhausting our bandwidth availability. However, this is not the case with many small providers that utilize other technologies. They are not able to carry hundreds of video channels. Consequently, they pay higher rates because they are not able to offer the content provider's full suite of channels to obtain the best pricing.

In addition to the cost increases we incur from the national content providers, we are now being asked to pay retransmission fees from the local affiliates. With the expiration of our local retransmission agreements at the end of 2005, some of the affiliates have requested per subscriber transmission fees be paid going forward.

Exclusive video content contracts with incumbent cable providers are an additional frustration when entering the video marketplace. At this time, we have been unsuccessful in obtaining sporting event content from a local content provider as the result of an exclusive agreement with the incumbent. In this particular instance, it is the end user consumer that loses as the customer who migrates from the incumbents service has to be satisfied without the content he was accustomed to.

An additional issue we have been battling relates to video transport. Since the beginning of 2005, we have been seeking authorization from the content providers to transport the video content we receive at our digital headend to adjacent telephone companies entering the video business. The sharing of a digital headend facility provides economies of scale that they would not achieve by constructing their own headend. Sharing equipment and staffing requirements would decrease their costs significantly to enter the video business. However, this has been a difficult process with a number of the content providers. Even though the closed transport network is secure and encryption technologies would be deployed, many of the content providers have been reluctant to provide authorization.

Based on our experience, I am hopeful the Committee will consider the following in order that small video providers, such as we, are able to enter to the video marketplace and provide affordable video service to our telephone and broadband customers in rural America:

- Excessive increases in video programming must be curtailed.

- Program rates and terms should be non-discriminatory.
- Exclusive programming contracts must be prohibited.
- Shared head-ends must be allowed.

It seems the burden of passing along the continued excessive video programming costs has been placed on the end-user video providers. To our detriment, the public views the increases as being created by the video providers and not the content providers who are at the root of the problem. The content providers escape the negative publicity of the rate increases as a result of their insulation from the public. We are hopeful that this information sheds light on some of the unique problems faced by a rural telecommunications carrier trying to enter the video market. We also hope that these issues will be discussed and addressed as the Committee looks to update our communications laws.

I respectfully request that this letter be submitted as part of the official hearing record. Thank you for your consideration and please feel free to contact me with any questions you may have.

Sincerely,

KEITH A. LARSON,
General Manager.

THE SPORTSMAN CHANNEL
January 31, 2006

Hon. TED STEVENS,
Chairman,

Hon. DANIEL K. INOUYE,
Co-Chairman,

Senate Committee on Commerce, Science, and Transportation,
Washington, DC.

Dear Chairman Stevens, Co-Chairman Inouye, and Members of the Committee:

I was asked to comment on one of the issues up for discussion during the video content hearing on January 31, 2006. Among the points that are likely to be raised is the question: Can a cable network be viable without securing a carriage agreement with Comcast? I write you today to let you know that the answer to that question is an emphatic, "Yes!"

The Sportsman Channel is living proof that start-up networks can survive and be successful without carriage on Comcast's cable systems. While other start-up networks have tended to rely on the fiction that obtaining a carriage agreement with Comcast is a prerequisite to getting carriage contracts with other multichannel video providers, we have taken a different approach: Provide a superior quality channel that attracts subscribers, and charge affiliates lower subscriber fees while providing quality customer service and first-class marketing tactics.

We also took the strategy of setting a launch date for The Sportsman Channel and keeping to it, even when we did not have a single carriage agreement signed by that date. It did not take long after our launch for us to secure our first carriage contract, and soon others followed. We successfully aired our network for over two and a half years before just recently convincing Comcast to sign a carriage agreement, the last large cable operator to sign.

For your convenience, I have attached an article I wrote last October that provides more information about The Sportsman Channel and how we successfully launched our network with quality programming, a solid business plan, and an experienced management team, but without Comcast. I hope you have an opportunity to see our programming some day so that you too understand why quality programming is the key to any successful network, and why we have been successful by taking the approach of: "If you can prove yourself, they will come."

Very truly yours,

C. MICHAEL COOLEY,
President and Chief Executive Officer.

ATTACHMENT

Multichannel News, Volume 26 No. 41, October 3, 2005

HOW I STARTED A NETWORK WITHOUT COMCAST

by C. Michael Cooley*

It has been said of late that if a network doesn't secure Comcast Corp., the Nation's largest MSO, then it will have a tough time even getting a foot in the door to start talks with the remaining cable providers.

Perhaps these folks haven't considered The Sportsman Channel (TSC) and how we had already secured the remaining cable operators: Time Warner Cable, Charter Communications Inc., Adelphia Communications Corp., Cox Communications Inc. and 14 other of the top 25 MSOs, all without the security or assistance of having Comcast. We are living proof that channels can survive without Comcast, contrary to the belief of many. TSC has been around for over two years and our channel, which is dedicated exclusively to hunting and fishing programming, is not just surviving, but flourishing.

Other start-up networks tend to have the approach of "If you have Comcast, they will come." Securing carriage is the key, but there is a formula: Provide a superior quality channel with lower subscriber fees that draws subscribers. Our team focuses on quality customer service and first-class marketing tactics to our affiliates, for an "If you can prove yourself, they will come" approach.

Another successful method for an independent channel employed at TSC was setting the launch date and keeping it.

The date never moved, even though we didn't have any agreements signed when the champagne popped on April 7. Our team approached the launch with 100 percent confidence in our product.

It certainly didn't take long after we drank the champagne for us to secure our first contracts with the National Cable Television Cooperative. This gained the attention of MSOs in the top 10—and eventually deals were struck in 2004.

We just recently completed our agreement with Comcast, which makes them the last of the top five MSOs to come on board, not the first. This proves that we didn't need a deal with them to validate our channel or secure distribution with other MSOs.

Some pessimists believe Comcast only launches channels if it is financially involved. TSC is an independent, and Comcast is, after all, still a business. It will launch channels that it believes will keep it competitive and increase subscriber counts.

No one knows better than me that starting a new channel in this market is a daunting and difficult task. But it can be done, and I am not sure if holding Comcast responsible is entirely the reason for the high level of complexity we experience as channel presidents.

That's especially true since there are 70 million other cable subscribers, plus another 25 million DBS subscribers out there.

Just because you are unable to be first to reel in a big fish doesn't mean the ocean won't provide you with a worthy catch.

CASTALIA COMMUNICATIONS
February 2, 2006

Hon. TED STEVENS,
Chairman,

Hon. DANIEL K. INOUYE,
Co-Chairman,

Senate Committee on Commerce, Science, and Transportation,
Washington, DC.

RE: SENATE COMMERCE COMMITTEE JANUARY 31 HEARING ON VIDEO CONTENT

Dear Senators Stevens and Inouye,

As the president of Castalia Communications, a company that was created 16 years ago as an independent distributor and producer of cable/satellite television

* C. Michael Cooley is president and CEO of The Sportsman Channel.

channels, I have had the pleasure of launching a variety of ethnic-based and general entertainment channels in the U.S. and around the world. More recently, these channel offerings have included services targeting the Mexican television viewer as well as audiences interested in the cultures and programming of Japan, China, Russia and Brazil, among theirs.

Recently, Castalia Communications has begun to work in collaboration with Comcast Corporation to reach American audiences with such channels as TV Globo Internacional from Brazil, Once Mexico, Mexico 22 and CBTV. In addition to these four channels, we are also exploring other opportunities to launch additional networks on Comcast systems. Overall, our experience with Comcast has been a positive one. Comcast has been very cooperative in giving us the opportunity to launch distinctive multicultural channels in the U.S. marketplace.

We believe that if you study and understand a marketplace, you can create and find opportunities. This is the approach that we have used in our effort to launch the aforementioned channels on Comcast systems. We did our homework, we shaped the concepts of our channel offerings to suit the needs of the audience and the marketplace, and we were able to make our channels attractive and valuable not only to Comcast, but also to other distribution companies like DIRECTV Charter and EchoStar's DISH Network.

Suffice it to say, we have found that there are not barriers to working with the largest video distributors if you deliver quality. If you have programming that has value to audiences, Comcast, like every other large and small distributor, will buy it or help you to get it to the consumer. But if your programming is not in demand or has no relevance to the viewer, or you don't have a business plan that makes sense to the cable and satellite competitors, then you will not find your role in the marketplace. That's the beauty of our democratic commercial system—the marketplace decides.

At the same time, there are numerous technical changes afoot in the entertainment business which open the door to a variety of delivery systems, of which Comcast is only one. If your channel concept isn't suited to Comcast's business model or distribution strategy, there are many other delivery systems available to reach the intended viewer.

First, there are a plethora of other multichannel system cable operators throughout the U.S. Second, there are satellite distribution networks like DIRECTV and EchoStar's DISH Network. And with the advent of broadband, online and wireless applications, you can now deliver your programming direct to the consumer via Internet service providers like Google Video and Yahoo!, as well as via video on demand offerings available through iTunes and every wireless phone company. All of them are eager to make content distribution deals for almost any programming imaginable.

These technology innovations have made it possible for anyone who has a compelling concept to break into the production and distribution business in the U.S. and have a shot at the big brass ring.

I understand that a witness has appeared before your Committee this week demanding that the government direct Comcast to carry their services. We think that would be wrong. It is utterly inappropriate for the government to skew the marketplace by involving itself in determining what programming people will see and in what form or package that programming will be delivered. That is offensive to American values.

In our experience, Comcast is a forward-looking company that makes programming decision in its customers' best interests, and is open to working with independent programmers with viable ideas, sound business plans and a win/win attitude.

Castalia Communication continues to operate as a successful independent company. Our dealings with Comcast have also been positive and mutually beneficial. This is why we oppose the efforts of those who would have the government making the programming decisions for Comcast or any other distributor in this marketplace.

Sincerely,

LUIS TORRES-BOHL,
President.

NTCA
January 30, 2006

Hon. TED STEVENS,
Chairman,
Hon. DANIEL K. INOUYE,

Co-Chairman,
Senate Committee on Commerce, Science, and Transportation,
Washington, DC.

Dear Senators Stevens and Inouye:

I am writing as the representative of over 560 rural, community-based telecommunications providers regarding the important hearing you are holding on January 31, 2006 on video content.

Due to the fact that no rural community-based traditional telecommunications provider was invited to testify, I thought providing the perspective of this industry would be invaluable to the Committee as it explores the issues surrounding content and access to content.

In addition to the basic and advanced telecommunications services all NTCA members offer to their customers, the vast majority also currently offer or are planning to offer video services. Our members offer video services to their subscribers utilizing various methods including traditional CATV coaxial, fiber cable, or Direct Broadcast Satellite (DBS). However, more and more of NTCA's members are utilizing the so-called Telco-TV model, providing video service via alternative broadband infrastructures and technologies, such as Digital Subscriber Line (DSL) over copper facilities.

Traditional telco entry into the video market is an exciting prospect for rural Americans. NTCA member companies serve the most rural segments of this country, where the cost and difficulty of providing service is the greatest. In many areas, NTCA member companies are the only providers of video service to these customers. For other areas, the NTCA member company is a new competitor. Our members are doing their best to ensure their communities have access to the most advanced communications services there are.

Small video providers, however, face many obstacles when trying to obtain video programming from content providers and attempting to enter new markets. Unreasonable rates, exclusive dealing arrangements, abuse of market power through non-disclosure agreements, tying practices, predatory pricing, shared head-end reservations, and prohibitions on Internet protocol (IP) and analog transport are some of the barriers faced by small video providers. In addition, small providers lack the leverage necessary to negotiate a better rate from the video programmers, forcing consumers in rural America to pay a premium for video service.

I have outlined for your consideration the barriers faced by rural providers below. It is my hope that your committee will review these barriers and take into account these situations in any legislative remedies the committee may be considering.

- *Non-disclosure agreements must be prohibited*. Virtually all of the contracts negotiated between content providers and large MSOs include non-disclosure agreements. By restricting the flow of information, the content providers make it virtually impossible to establish any semblance of "market rates." Consequently, smaller carriers must enter into their negotiations at a significant disadvantage, as they possess far less information than the party with whom they are negotiating.
- *Automatic escalation clauses must be reasonable*. Contracts for programming typically contain automatic escalation clauses forcing prices up by a certain percentage each year. Small video service providers lack the leverage necessary to negotiate a better rate from the video programmers, forcing rural Americans to pay a premium for video service.
- *Tying arrangements must be prohibited*. Many networks require a carrier to take additional networks, as many as 12, in order to have access to a flagship network. The end result is that the small carrier must pay a higher price in order to ensure access to the desired flagship network. This problem is much more dramatic for a small carrier with limited capital resources than for a large MSO that can afford to pay for the extra networks.
- *Program rates and terms should be non-discriminatory*.
- *Predatory pricing by large incumbent cable operators must be prohibited*. As new providers enter the market, the large incumbent cable operator may drop its price for service way below the cost in the areas where it faces competition, making it impossible for the new entrant to gain a foothold. The incumbent cable operator is able to afford this practice by increasing the price for service in areas where there are no competitors.
- *Exclusive programming arrangements must be prohibited*. Some incumbent cable operators use their market power to make it difficult for competitors to obtain programming. The incumbents know that without access to certain pro-

gramming, competitors cannot make their service attractive to subscribers. Certain large cable incumbents are known to have entered into exclusive programming arrangements. Contracts are written in such a way as to bar new entrants from access to local or regional sports or news programming. Local subscribers expect programming and are unlikely to switch to a new provider that is unable to provide it.

- *IP-transport must be allowed*. New small Telco–TV/IP–TV providers are facing discriminatory practices concerning their ability to get into the video services marketplace and gain access to video content because some content providers prohibit their video content from being distributed through DSL or the Internet. They claim that IP-transport prohibition is required to prevent the piracy of their content on the Internet. This concern however, is easily addressed through today's encoding and encryption capabilities that enable IP-transport to be more secure than traditional cable transport.
- *Shared head-ends must be allowed*. Many small video companies have created an opportunity to provide video services to their communities by pooling their resources and jointly purchasing a head-end or leasing a head-end from another head-end owner. Sharing a head-end with several small companies substantially reduces initial investment and allows small video providers the opportunity to give consumers an affordable video services offering. Without the shared head-end option, many rural consumers would not have video service or would be limited to direct broadcast satellite service (DBS) without any other competitive offering.
- *Encryption must not be mandatory for traditional CATV providers*. Some content providers are insisting that small analog cable TV providers upgrade their systems to support encryption. Many small rural video providers do not have the economies of scale and scope to incur the cost of providing encryption on their networks. Mandatory encryption would result in such a substantial increase in rates to consumers that it would effectively put the small company out of the video business and leave the residents in the community with possibly only one option for video services—DBS.

I respectfully request that this letter be made a part of the official permanent hearing record. Thank you for your time and consideration.

Sincerely,

MICHAEL E. BRUNNER,
Chief Executive Officer.

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