

# **RETRANSMISSION CONSENT, MUST CARRY AND THE PUBLIC: CURRENT ECONOMIC AND REGULATORY REALITIES OF MULTICHANNEL VIDEO PROVIDERS**

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## **NOTICE**

The opinions expressed in this paper are those of the individual authors and the Digital Policy Institute alone and do not necessarily represent the views of Ball State University. The Digital Policy Institute may be contacted at [policy@bsu.edu](mailto:policy@bsu.edu).

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## Executive Summary

Shifts in technology and changes to the economic landscape since 1992 suggest that statutory provisions that support must carry and retransmission consent are ripe for review. The major findings and recommendations of this paper are:

- **The Myth of an “Open” Marketplace for Negotiations**

A statutory environment exists which supports the maintenance of a skewed playing field where a single seller (broadcaster) controls all elements of price, terms and conditions of negotiations with multiple buyers (MVPD). Allowing the use non-disclosure agreements to hide the terms and price of agreements with other systems prevents the establishment of a marketplace price for content and, in turn, limits the opportunity for negotiations between parties in an open market.

- **Disproportionate Bargaining Power**

The regulatory imbalance created by antiquated statutory requirements for must carry and retransmission consent can be corrected through a consistent policy which mandates binding arbitration when no consensus is reached between parties during retransmission consent negotiations. This imbalance is especially critical for smaller, independent MVPD firms in rural areas who suffer disproportionate bargaining power because of size and the inability to collectively “pool bargain.”

- **Market Realities Have Changed Since 1992**

The statutory rules that regulate major network-cable system retransmission agreements were established in 1992. Over the last fifteen years both the technology and the economic landscape relevant to this bi-lateral market has changed. These transformations in the market have tilted bargaining power towards favoring owners of major broadcasting network rights. This shift in power is especially harmful to the interest of smaller independent and rural MVPD operators and their customers. Modifications of the rules governing retransmission agreements ought to be examined

- **Retransmission Consent**

Retransmission Consent and Must-Carry, two sides of the same coin, have developed into a somewhat contentious issue between broadcasters and MVPDs. Complaints come from the broadcasters that they should not be the only program suppliers not receiving compensation from cable, and from MVPDs who don't understand why they should be required to pay for programming that is available without charge over the air waves.

**ACTION ALTERNATIVES: Create a True Marketplace**

- **Out of DMA Negotiation for Small Market MVPDs**

In the negotiation between content providers (networks, stations and syndicators) and the delivery systems (cable systems), the best outcomes for consumers result when there is a balance of power between the two parties. This balance seems to currently exist in large markets but in small markets, content providers are in the position of power. They offer a monopoly product that the MVPDs can get from no other provider, yet they lack the subscriber base to have any clout. Content providers can easily make “take-it-or-leave it” offers. In order to level the playing field, small market delivery systems (cable and telco) ought to be able to negotiate with more than one provider of the same content.

- **Pooled Negotiation**

One approach to equalizing bargaining power in the retransmission consent negotiations is to allow small MVPDs to collectively bargain with owners of network transmission rights. Such pooled bargaining already occurs implicitly when large commercial cable systems negotiate with owners of network transmission rights. Authorizing and legally sanctioning such “pooled bargaining” would place small rural operators and their customers on par with owners and subscribers of larger cable systems. Although such a system would provide little incentive for cable operators who are in head-to-head negotiations with independent local network affiliates, it could provide leverage for those who negotiate with large media holding companies who hold local licenses in a number of markets.

- **A Coming Détente?**

As new multichannel video programming distributors; Telcos, satellite providers, and the Internet vie for customers and dollars, the MVPD industry faces increased financial challenges. Fortunately, there seems to be an awareness among the many players involved in traditional television delivery modes that they need to find ways to compete without alienating viewers. There is one option that has floated recently; Save Our Sets, which offers an alternative to the FCC’s Voucher plan for the looming digital transfer.

## **Communications Policy, Copyright and Contractual Agreements**

### **The History and Rationale of the FCC Local Broadcast Station “Must Carry,” “Network Nonduplication,” “Syndicated Exclusivity” and “Retransmission Consent” Rules**

#### **Introduction**

Over the course of the past four decades, the Federal Communications Commission – subject to the general and sometimes very specific direction of the United States Congress – has developed a comprehensive and frequently amended set of regulations governing the carriage and “economic protection” of local stations on local cable television systems and over other terrestrial and space-satellite based multichannel video providers. These regulatory initiatives have been premised on a variety of communications policy choices. One of these policy choices is based on the FCC’s well-established system for allocating television channels across the country. This policy has resulted in television station opportunities being distributed among hundreds of communities across the country, rather than assigned to a smaller number of large metropolitan areas. Contractual, “equity” and copyright-related considerations also have supported the FCC’s cable rules as relevant to TV station carriage.

The key consideration in the “must carry” rules is ensuring that citizens in local communities can benefit from the program service provided by these stations, regardless of whether the viewer receives local stations “over-the-air,” with a rooftop antenna, via a common antenna serving multiple dwelling units, through set-top “rabbit ears” or by way of a subscription to a multichannel provider. In many respects these rules are aimed at supporting the financial viability of local stations and ensuring that they have the economic capability of providing programming valued by, and beneficial to, local

citizens. The FCC reasons that if a station is licensed to a particular community and obliged to offer programming responsive to local interests, all citizens of the community should have access to that programming, regardless of whether they subscribe to a multichannel video provider.

Related regulations – some the product of more focused legislative direction – have addressed matters aimed at achieving much the same benefits for local broadcasters. These regulations offer “exclusivity” protection to stations’ network programming and syndicated programming (*e.g.* reruns of former network programs, “first-run” syndicated programs, motion picture packages, etc.), though the two sets of rules have differing provisions. Although matters of contract law and copyright are implicated by the network program nonduplication and syndicated program exclusivity rules, these regulations also have been premised on the “protection” of local broadcasting.

The “retransmission consent” option given local broadcasters is one – based on specific statutory direction from Congress – aimed at ensuring that stations receive “compensation” for cable carriage of their valuable product. It gives recognition to the fact that cable systems pay to carry cable “networks,” such as USA Network, Discovery, CNN, the Cartoon Network, etc. and that a similar economic relationship should exist between cable systems and local stations, the cable audiences of which can be among the largest of all cable viewing. Every three years a local station is given the choice of seeking traditional “must carry” for its signal or – in lieu of the certainty of non-compensated “must carry” – seeking “retransmission consent” of local and regional cable systems as a precondition to carriage. If a station choosing to pursue retransmission consent is unable to reach an agreement with a cable operator for the latter’s payment of

something of value (money, giving the station access to another cable channel for additional programming efforts, etc.) to the former, the station's signal (including local, network and syndicated programming) is not available to the local audience. During such standoffs, cable systems are not allowed to "import" signals of other stations airing programming which, pending resolution of a retransmission consent dispute, is broadcast by the local station but is not available to subscribers of the local cable system.

Most of these "core" cable television rules – all but the retransmission consent provisions – developed at a time when the FCC had a very different set of broadcast programming and license accountability regulations than those which exist today. In the past, the Commission had imposed a pervasive set of substantive programming regulations which demanded that specific amounts of local programming be aired by stations, mandated that stations keep in continuing contact with local and regional organizations in order to "be in touch" with the local community (and, therefore, be better positioned to offer programming meeting local needs and interests) and required stations to submit frequent and thorough substantiation of the station's programming and other efforts in order to achieve renewal of the broadcast license. Significant FCC deregulation in these broadcast programming and station "accountability" areas may be relevant to efforts at reviewing many of the cable television and multichannel provider regulations – and relevant statutory law – addressed here.

## **FCC “Station Allocation” Policy – A Foundation for the Rules Addressed Here**

Among the elements of the Radio Act of 1927<sup>1</sup> – the predecessor statute to the Communications Act of 1934<sup>2</sup> – were Congressional provisions directing the Federal Radio Commission (“FRC”) to eliminate the chaotic interference found on the AM broadcast band and to establish an “equitable” system for allocating frequencies among geographic areas. In 1928, the Congress amended<sup>3</sup> the Radio Act to require the FRC, as best it could, to equalize the number of stations in the five geographic zones which the Commission divided the country.

The Communications Act did not adopt such a rigorous allocations structure. Instead, the Act called on the Commission to “make such distribution of licenses, frequencies, hours of operation, and of power among the several States and communities as to provide a fair, efficient and equitable distribution of radio service to each of the same.”<sup>4</sup> Similarly, the Commission placed limits on networks’ ability to influence local stations’ programming choice and, thereby, stations’ attention to local matters. The FCC’s “chain broadcasting” rules – adopted in 1941<sup>5</sup> and affirmed by United States Supreme Court in 1943<sup>6</sup> – demonstrated the Commission’s continued focus on encouraging local programming of stations and the agency’s desire that local programming decisionmaking not be influenced excessively by stations’ relationships with network organizations.

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<sup>1</sup> Radio Act of 1927, Pub. L. 632, February 23, 1927, 69<sup>th</sup> Congress.

<sup>2</sup> Communications Act of 1934, Pub. L. 416, June 19, 1934, 48 Stat. 1064, 73<sup>rd</sup> Congress.

<sup>3</sup> 45 Stat. 373, August 30, 1928, passed as part of the 1928 reauthorization of the Federal Radio Commission.

<sup>4</sup> 47 U.S.C. § 307(b).

<sup>5</sup> See *FCC Report on Chain Broadcasting* in Docket No. 5060, released May 2, 1941.

<sup>6</sup> *National Broadcasting Co. v. United States*, 319 U.S. 190 (1943).

In 1952, this time in the context of television broadcasting, the FCC made the policy choice to encourage “local” service by this “new” medium, rather than to allow “national” coverage by stations.<sup>7</sup> The Commission believed it was obligated to take a locally-oriented approach to station allocation, etc., due to the strictures of Section 307(b) of the Act. The Commission created a “table of allocations,” indicating which television channels would be available in communities of various sizes throughout the nation.

This allocation policy was the first of the components that support the “localism” concept in American television broadcasting. Stations are licensed to particular communities and also have been required – first to a greater and now to a lesser extent – to demonstrate, at time of initial licensing and periodically when seeking license renewal, that the station has assessed local needs and interests and will provide, or has provided, programming to meet those needs and interests. The FCC’s generalized requirement that stations now offer “issue-responsive” programming is a far cry from previous regulatory regimes forcing stations to stay in continuing contact with local organizations and community leaders, and to offer specific amounts of “non-entertainment” programming, much of which was expected to be of a locally-oriented nature. But, even today’s generalized requirement supports the notion that station licenses were distributed among the several states and communities to provide a program service of value to local citizens. It is this local service, and ensuring the economic viability of stations licensed to provide this service, that supports the “must carry” rules and the various other rules governing program exclusivity and cable carriage rights.

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<sup>7</sup> *Sixth Report and Order* in Docket No. 8736, 41 FCC 148 (1952).

## FCC “Must Carry” Rules

The FCC’s “must carry” rules, which generally require cable television operators to carry local television stations on their systems, were among the first cable television rules promulgated by the Commission. As discussed briefly, below, these rules have taken on various forms over the years, are now based on a specific federal statute and have withstood several serious court challenges. With digital TV broadcasting supplanting analog broadcasting as the Congressionally-imposed analog “drop dead” date of February 17, 2009, approaches, the must carry concept still is at the forefront of federal policymaking and inter-industry warfare. The ability of a station to offer up to four or five programs over the same sized frequency band (6 MHz) that stations have used from the outset of television broadcasting in the United States has posed a new dynamic between the cable/multichannel providers and the over-the-air television industry.

Government and communications industries are facing a reassessment of these rules as they apply to digital television and the digital transition. Broadcasters want – during the transition – to have “must carry” of both the digital and analog signals. And for the digital signal, station operators strongly favor must carry rules that would require a cable operator to distribute all the programming – including “multicast channels” – offered by a digital TV station. Thus far, the FCC has chosen *not* to grant cable carriage rights to the entirety of a digital TV station’s bitstream. Instead, current FCC rules only require cable carriage of a station’s “primary video” – one program stream designated by the broadcaster as “primary.” For broadcasters, this is still a “fighting issue.” Further deliberations at the FCC and at the Congress are certain on this issue. In July 2007, cable

television interests stated their vigorous opposition to the proposal of FCC Chairman Kevin Martin that stations exercising their “must carry” rights have their analog and digital signals carried by cable TV systems.<sup>8</sup> It seems likely that a legislative – rather than regulatory – effort would be needed to provide certainty in this area.

The FCC’s significant regulation of cable television today is in sharp contrast to the agency’s original posture when cable TV – then known as “community antenna television system” or “CATV” – first developed in the 1950s. On the twin bases that the Congress had not given the FCC specific regulatory authority and that cable television didn’t use the “over-the-air spectrum,” the FCC first avoided entirely the adoption of cable TV rules.

But, in 1962, in its *Carter Mountain Transmission Corporation* decision, the Commission reversed course on cable when a system proposed to “import” distant signals into a local television market via common carrier microwave. Those signals, carried on cable, would have duplicated the local station’s network programming. On the theory that such a practice would result in cable affecting broadcasting negatively, the FCC denied the microwave application and said that it only would consider a refiled microwave application if the cable system promised to carry local stations and not to distribute the signals of other stations that might be carrying duplicating programming.

By the mid-60s the FCC had adopted its first formal set of cable television regulations.<sup>9</sup> The rules required carriage of the “closest” network affiliated stations and placed severe restrictions on the importation of out-of-market stations. Cable TV interests challenged the FCC’s authority to promulgate these regulations. But, in its 1968

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<sup>8</sup> “Martin Ready to Hit Cable with Dual Carriage Rules,” *Multichannel News*, September 4, 2007.

<sup>9</sup> *Second Report and Order*, 2 FCC 2d 725 (1966).

*U.S. v. Southwestern Cable Co.* decision,<sup>10</sup> the U.S. Supreme Court affirmed the FCC's jurisdiction over cable. The Court accepted the "ancillary to broadcasting" jurisdictional theory for cable regulation and also found support for such jurisdiction in the general provisions of the Communications Act.

A more comprehensive set of cable rules took effect in 1972.<sup>11</sup> Under this new regulatory scheme, a cable operator was required to obtain a "certificate of compliance" prior to inaugurating cable service or adding a broadcast signal to an existing cable system. These rules incorporated carriage requirements for full-service stations casting a "Grade B" signal strength contour over the cable community, "translator" stations in the cable community with 100 watts or higher power, noncommercial educational stations within 35 miles of the cable community and also stations "significantly viewed" over-the-air in the cable community.

Since that time, the FCC's must carry rules have undergone several changes, in part due to the results of court proceedings questioning the rules on Constitutional grounds. In the *Quincy Cable v. FCC* challenge to the must carry rules, the United States Court of Appeals for the District of Columbia Circuit found that the rules were in violation of the First Amendment and beyond the FCC's regulatory jurisdiction.<sup>12</sup> Two years later the FCC adopted "interim" must carry rules that also were challenged and struck down by the same federal appeals court.<sup>13</sup> This time the appeals court did not find that the rules necessary were unconstitutional. It only found that the FCC had failed to

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<sup>10</sup> 392 U.S. 157 (1968).

<sup>11</sup> *Cable Television Report and Order*, 36 FCC 2d 143 (1972).

<sup>12</sup> 768 F.2d 1434 (D.C. Cir. 1985).

<sup>13</sup> *Century Communications Corp. v. FCC*, 835 F.2d 292, 293 (D.C. Cir. 1987).

provide a compelling reasoning to support its rules. The U.S. Supreme Court refused to hear the case in response to a petition for certiorari.<sup>14</sup>

The 1992 Cable Act codified the must carry rules. But, then again they were challenged in court. After a court of appeals decision and a Supreme Court remand back to the lower court, the Supreme Court ultimately affirmed the FCC's must carry rules as "content neutral" and not in violation of cable operators' First Amendment rights.<sup>15</sup>

### **FCC "Network Program Nonduplication" Rules**

First imposed during the early periods of cable television regulation, and modified periodically since that time, the rules<sup>16</sup> now require that, upon request of a television station affiliated with a broadcast network, a cable television system operating in the "specified zone" (a market-type designation) of the station delete any duplicating network programming broadcast by other stations carried on the system. The rules afford protection to commercial network and noncommercial network station affiliates. Although subject to more complicated provisions, stations' network programming also is afforded protection against carriage of duplicating programming by satellite television carriers.<sup>17</sup>

### **FCC "Syndicated Program Exclusivity" Rules**

Protection of local stations' syndicated programming has had a somewhat shorter history at the FCC. Adopted to protect the off-network, first-run syndication and other

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<sup>14</sup> 486 U.S. 1032 (1988)

<sup>15</sup> *Turner Broadcasting System, Inc., v. FCC*, 520 U.S. 180 (1997).

<sup>16</sup> 47 C.F.R. §76.92.

<sup>17</sup> See Satellite Home Viewer Improvement Act of 1999, Pub. L. No. 106-113, 113 Stat. 1501, 1501A-526 to 1501A-545 (Nov. 29, 1999).

non-network programming of stations, the comprehensive exclusivity rules adopted in the Commission's omnibus 1972 *Second Report and Order*<sup>18</sup> were repealed in 1980.<sup>19</sup> However, the repeal was shortlived as the Commission, in the late 1980s, decided to restore the rules<sup>20</sup>. Effective again in 1990, the rules require a cable system to “black out” syndicated programs shown by distant stations (including “superstations”) carried on the cable system when the local station has signed a market-exclusive contract to air the program. The geographic area of protection of syndex is dependent on the terms of the contract negotiated by the station and the program supplier. FCC rules require that contract language contain government-specified language for the local station to qualify for syndicated exclusivity protection. The syndicated program exclusivity concept has been extended to rules governing satellite television carriers.

### **Retransmission Consent Provisions**

The concept that cable television systems obtain the consent of local broadcast stations in order to carry them has been before the government for decades. In 1965, while the FCC was undertaking a thorough review<sup>21</sup> of what its regulatory posture should be toward cable television, it considered whether Section 325(a) of the Communications Act – a provision that forbids the “rebroadcast” of a station's signal without its permission – also should apply to cable TV's retransmission of a station's signal. While the FCC declined to adopt that view, the Commission did express its intent to seek a

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<sup>18</sup> Cable Television Report and Order, *supra* n. 11.

<sup>19</sup> *Report and Order* in Docket Nos. 20988 and 21284, 79 F.C.C. Rcd 663 (1980).

<sup>20</sup> *Memorandum Opinion and Order*, 4 F.C.C. Rcd 2711 (1989).

<sup>21</sup> *Rules re Microwave-Served CATV*, 38 F.C.C. 683, 741 (1965)

Congressional amendment to Section 325(a) to extend the “consent” requirement to cable TV.

But, in the years immediately to follow, no such statutory amendment was forthcoming. In 1968 the FCC proposed – but never adopted – a rule provision under which a cable system wishing to “import” a distant signal into a local market could do so if it obtained the “retransmission consent” of the distant station it desired to carry.<sup>22</sup> This proposed rule would have allowed a cable system to avoid having to make the required showing (under the carriage rules then in place) that carrying a distant signal would be “consistent with the public interest, and specifically the establishment and healthy maintenance of television broadcast service in the area.”<sup>23</sup>

Also, during the late 1960s and early 1970s, cable television benefited from court decisions holding that cable’s retransmission of television signals did not constitute a copyright infringement, that cable did not “perform” television stations’ programming under the terms of the 1909 Copyright Act and that a cable system only served as an “extension” of the viewer’s antenna.<sup>24</sup> The Court concluded that broadcasters simply “released” their programming to the public<sup>25</sup> and that losses to copyright owners were of “little relevance.”<sup>26</sup>

In response to the *Fortnightly* line of cases, there was heavy lobbying of the Congress to amend the 1909 Copyright Law to recognize the value of broadcast programming to cable operators and their “performing” of this programming through

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<sup>22</sup> *Notice of Proposed Rule Making and Notice of Inquiry*, 15 FCC 2d 417, para 38 (1969).

<sup>23</sup> *Second Report and Order*, 2 FCC 2d 726, 804 (1968).

<sup>24</sup> *Fortnightly Corp. v. United Artists TV, Inc.*, 392 U.S. 390 (1968). See also *Teleprompter Corp. v. CBS Inc.*, 415 U.S. 394 (1974).

<sup>25</sup> *Teleprompter*, 415 U.S. at 403.

<sup>26</sup> *Id.* at 413, n. 15.

their distribution of television broadcast signals to cable subscribers. Based in part on cable operators' support for a copyright law revision, a new approach to cable copyright was created as part of the 1976 Omnibus Revision to the Copyright Law.<sup>27</sup> It imposed a limited form of copyright liability on cable television while protecting the cable industry from heavy license fees and expensive costs of negotiating for the right to retransmit broadcast signals. Rather than requiring the negotiation of a mutually-agreeable price for cable TV's use of copyrighted programming, the law allowed cable to obtain a compulsory license and to pay fees to the government for distribution to copyright holders filing claims.

As early as the late 1970s there were serious discussions in government about substituting a retransmission consent system for the compulsory licensing scheme adopted in the revised copyright law.<sup>28</sup> Broadcasters again viewed cable systems' revenues and, believing that these revenues were derived substantially by cable subscribers' viewing broadcast signals, the industry increased its call for a system of retransmission consent and compensation. That pressure, among others, led to the passage of the Cable Act of 1992.<sup>29</sup>

The 1992 Act, which overcame a presidential veto, did not repeal the compulsory licensing system for distant signal carriage but gave local broadcasters the right to determine whether to seek guaranteed "must carry" or, instead, to offer retransmission consent to cable operators with whom the broadcaster would negotiate the value of the signal to the operator and its subscribers.

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<sup>27</sup> Pub. L. No 94-553, §111, 90 Stat. 2541, 2550 (codified as amended at 17 U.S.C. §111).

<sup>28</sup> H.R. 3333, 96th Cong., 1st Sess. sec. 453 (1979).

<sup>29</sup> Cable Television Consumer Protection and Competition Act of 1992, Pub. L. 102-385, 106 Stat. 1460.

## **LOCAL COMMERCIAL TELEVISION STATION BUSINESS MODELS**

Since the first licensed stations went on the air, commercial TV stations have relied primarily on advertising revenue as their major source of income.<sup>30</sup> Advertisers were initially attracted to television because of its ability to transmit pictures (which radio could not) that moved (which newspapers could not). Although the 1950s are often considered the Golden Age of Television, viewership still lagged behind the audiences for radio and newspaper. It was not until years later that local TV stations became the providers of the largest audiences in the market.

Obviously advertising revenue is based on audience size, but all audiences are not created equal. Advertising executives expect that a magazine advertisement will “last” longer than a newspaper ad because people tend to throw out newspapers after a day, while a magazine tends to remain around the house longer. The same ad in both media might have more “impressions” in a magazine because it is seen more times. Generally speaking a commercial on radio and television that reaches exactly the same size audience is more valuable on television because of the added dimension of video.

Even within media, advertisements have varying value based both on the audience demographics and the expectation that a viewer will remain attentive through a commercial break. Young males (18-34) are considered a difficult television audience to reach so programs that successfully attract them in higher numbers can charge a premium rate for advertising time. Research also shows that live events (such as sports) seem to

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<sup>30</sup> It was different with radio. In 1920 Westinghouse put a station on the air largely to sell radio receivers. Commercial TV was first authorized in 1941.

keep viewers from channel surfing more than other program types, thus making their audiences a little more valuable.

To make matters even more confusing, an advertisement within a particular program on a particular station might cost different amounts for different advertisers (this is perfectly legal). A station might have a published rate for a commercial, but the car dealership that buys hundreds of spots each month receives a discounted rate. A local dry cleaner that wants to purchase only one commercial pays a higher rate for that 30 seconds, but not as high as a national advertiser like Coca-Cola.

Finally, ads within a commercial “pod” (a group of commercials aired back-to-back) usually cost more for the first and last position than they do for the “interior” spots because of the retention principles of primacy and recency.

All of this background is provided as context for understanding that audience size matters but it is far from the only factor television stations use in determining advertising rates.

## **NETWORK AFFILIATION AND COMPENSATION**

Networks were created by radio and television companies as a means of sharing content. This would simultaneously reduce programming costs and increase audience size. In the early days of radio, live music performance constituted a large part of the popular evening programming. Rather than have an orchestra in every city, one orchestra could provide live music for all those cities. In television it would be impossible to produce the quality of programming we have come to know by having each station in

each city produce its own. The only effective means of doing this is to “pool” resources, which is how networks were established and how they continue to work today.

For decades the networks and their affiliated stations had a mutually beneficial relationship. The networks had the high-quality programs that the affiliates wanted and the local stations had the audiences that the networks wanted to reach. It was a marriage made in heaven. Networks not only provided the programs to the affiliates, they actually paid compensation (network “comp”) to the affiliates for carrying the programs. Because every affiliate added to the audience size, it enabled the networks to charge advertisers more. Network comp was not usually offered for programs like the typical Sunday morning public affairs fare. Neither was comp the same for programs in daytime as it would be for prime time shows. Compensation was usually based on the local stations’ rates. For example, when CBS aired *The Ed Sullivan Show*, the hour-long program might contain eight minutes of network commercials. CBS might provide compensation of 20 percent of a station’s commercial rate for the commercial time within that hour. If a station would have typically charged \$100 for a minute’s time, the network comp would have been \$160 (eight times \$20) to that station. Larger and smaller payments were made to nearly 200 CBS affiliates across the country.

As might be expected, network comp was greater in larger markets<sup>31</sup> that could charge more for their advertising, but ironically it provided a larger *percentage* of a smaller market station’s income.<sup>32</sup> Because many commercial spots would go unsold, or

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<sup>31</sup> “Markets” are Designated Market Areas (DMA) as determined by Nielsen. Market rank is based on the population within the DMA with New York as the largest (with over 7 million households) and Glendive ranked 210<sup>th</sup> (with under 4,000 households).

<sup>32</sup> D. Mermigas, “Compensation At a Glance,” *Electronic Media*, Dec. 19, 1988. According to Mermigas, network comp was 4-8 percent of a top-50 market station’s revenue, but it was 40-50 percent of a smaller station’s annual net income.

because rates would be dramatically reduced for local advertising, and smaller markets received less of the lucrative “national spot” advertising, network comp was an important part of a small station’s budget. As recently as six years ago, stations in market size 90 and higher<sup>33</sup> would show no profit at all were it not for network comp.<sup>34</sup>

Networks started hinting about cuts in comp in the late 1980s,<sup>35</sup> and the first changes were relatively minor. It was the end of the honeymoon period for network/affiliate relations. Stations tried to work with networks to avoid the inevitable but the shift had already begun.<sup>36</sup> In 1990 CBS announced plans to cut comp 20 percent, saving the network (and costing the local stations) an estimated \$30 million.<sup>37</sup> CBS admitted that it had been “too aggressive” in trying to reduce compensation too quickly and reduced the cuts.<sup>38</sup> The network still believed in cutting compensation, but maybe not so abruptly. The equation continued to change throughout the 1990s. Television network executives, most notably Disney/ABC head Michael Eisner, began announcing publicly that in an effort to reduce network expenses, compensation for affiliates was one of the costs they were seeking to reduce, if not eliminate. Citing higher programming costs to acquire increasingly-expensive content (for ABC, especially the rights to *Monday Night Football*), networks reduced the amount paid to affiliates. News media immediately

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<sup>33</sup> Using 2007 figures, Burlington-Plattsburgh is the 90<sup>th</sup> market with 327,480 households.

<sup>34</sup> S. McClellan, “Small Towns, Big Problems,” *Broadcasting & Cable*, Aug. 6, 2001.

<sup>35</sup> D. Waters, “ABC TV Affiliates Encouraged By New Shows, Managerial Commitment,” *Television Digest*, June 12, 1987.

<sup>36</sup> D. Mermigas, “Fee Cuts to Hit Hard, Some Affiliates Warn,” *Electronic Media*, Dec. 19, 1988.

<sup>37</sup> S. Wollenberg, “Plans 20 Percent Cut in Payment to TV Network Affiliates,” *The Associated Press*, Nov. 20, 1990.

<sup>38</sup> R. Huff, “CBS Admits First Comp Plan a Killer,” *Daily Variety*, Oct. 8, 1992.

reported a drop in stock prices for television station group owners.<sup>39</sup> Growth projections for television stations were lowered for years to come as a result of lost compensation.<sup>40</sup>

Now the issue has become reverse compensation, where the affiliate pays the network to provide it with programs. The first known instance of reverse comp occurred in 1988. ABC affiliates became “very nervous” when the first station paid to become a network affiliate, but ABC insisted it was an anomaly.<sup>41</sup>

The tipping point appears to have been the NBC affiliation agreement in San Francisco, entered into in 2000 with KNTV, a Granite Broadcasting-owned station. For decades NBC had been affiliated with KRON in San Francisco. When the station was sold to Young Broadcasting, NBC told the new owners that network affiliation was not automatic, and that they would have to pay for that privilege. Young refused, so NBC made a deal with KNTV for \$362 million in reverse compensation over nine years.<sup>42</sup> There was a landslide of reaction, including terms such as “heavy-handed,” “far-reaching” and “anti-competitive.” Most asserted it signaled the end of amicable relationships between networks and affiliated stations. That same year UPN terminated its affiliation with a Salt Lake City station in favor of what had been a home shopping channel because the former demanded network compensation while the latter was willing to provide reverse compensation.<sup>43</sup>

Fear spread to other affiliates and CBS told its stations that it did not believe reverse compensation would become the norm. Fast forward to 2006, and CBS’s Les

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<sup>39</sup> D. Mermigas, “Station Economics Rocked,” *Electronic Media*, Feb. 2, 2000; J. Lafayette, “Comp Cut 25%,” *Electronic Media*, Dec. 13, 1999.; E. Rathbun, “KRON-TV’s Price of Freedom,” *Broadcasting & Cable*, Apr. 10, 2000.

<sup>40</sup> “Kagan Forecasts Central Gulf as Top Growing Broadcast Region,” *Business Wire*, Jan. 20, 2006.

<sup>41</sup> A. Buckman, “Affiliation Sale Rattles TV Stations,” *Electronic Media*, Oct. 31, 1988.

<sup>42</sup> “NBC-Granite Deal Rankles Big Groups,” *Television Digest*, Feb. 21, 2000.

<sup>43</sup> J. Lafayette, “UPN Dumps KJZZ Over Comp,” *Electronic Media*, Oct. 23, 2000.

Moonves spoke before investors and told them he expected to extract reverse compensation “in the next few years.”<sup>44</sup> Fox affiliates were told in 1999 that they would have to pay reverse comp.<sup>45</sup> As a means of softening the blow Fox made additional times available for stations to sell commercials, but stations still had to pay an estimated \$18 million in reverse comp.

Interestingly, the network/affiliate struggles may have helped to fuel the increasing media concentration after the passage of the Telecommunications Act of 1996. In 2000, Lee Enterprises Chairman Richard Gottlieb lamented the fact that his group of stations was not large enough to force CBS to negotiate with them, rather than simply eliminate network compensation.<sup>46</sup> He stated that they would not be able to remain at their current size and be successful.

Not all network/affiliate contracts become public, but those that do show the wisdom of Gottlieb’s remarks. In the network/affiliate struggle, it appears larger station groups with more successful ratings have the ability to strike better deals than smaller groups or those with lower ratings. In 2000 NBC was seeking affiliation agreements that included reverse compensation. Hearst-Argyle was able to avoid reverse comp and was even able to negotiate payments to it from the network, albeit decreasing each year. Gannett, NBC’s largest affiliate group struck a deal that cut its network compensation by two-thirds but nonetheless continued it at a time when other affiliates were paying reverse compensation.<sup>47</sup> Conversely when My Network TV was launched, the weakness

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<sup>44</sup> S. Zeitchik, “Les Looks for Profit Punch,” *Daily Variety*, Jan. 27, 2006.

<sup>45</sup> “Fox Affiliates to Approve Reverse Compensation Plan They Don’t Like,” *Communications Daily*, June 21, 1999.

<sup>46</sup> “Lee Confirms Cut in CBS Compensation Payment,” *Electronic Media*, Feb. 14, 2000.

<sup>47</sup> S. McClellan, “NBC Comp’s New Phase,” *Broadcasting & Cable*, July 24, 2000.

of its initial position and need for affiliated stations meant that local stations would not be expected to pay reverse comp.<sup>48</sup> It's all about who is in the position of power.

Network compensation was the biggest issue behind the strained network/affiliate relations but it was far from the only issue. ABC affiliates agreed to pay reverse compensation for *Monday Night Football* but demanded that the network use less of the same programming on cable properties, for example, ABC Family.<sup>49</sup> The network would air a program on affiliates and within days air the same program on cable, obviously diluting the audience. Also a bone of contention among affiliates was the amount of network-cable cross-promotion.<sup>50</sup> It was frustrating for a local station to carry an ABC newscast during which a promotion would run encouraging viewers to watch a program later that evening on ESPN, another Disney-owned property.

There is an even greater threat to local stations than dilution of network content by rebroadcast – online availability and Video on Demand (VOD). Networks making their programs available at their websites destroy the “exclusive” franchise that local stations once enjoyed. Entire episodes of *CSI*, consistently one of CBS's highest rated programs, are now available at CBS.com, with fewer commercial minutes than on the local station. In a digital world, an ABC affiliate is no longer the exclusive purveyor of *Desperate Housewives* to people within the market. Through the ABC.com website, fans of the show can purchase DVD sets of entire seasons, buy downloads through iTunes, or watch episodes streamed for free. CBS has announced that it is striking deals with AOL,

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<sup>48</sup> “Bright Future for Affils,” *Television Week*, March 6, 2006.

<sup>49</sup> S. Brown, “ABC's Push-Me, Pull You,” *Mediaweek*, Oct. 7, 2002.

<sup>50</sup> T. Case, “Still Nasty, After All These Years,” *Mediaweek*, Nov. 11, 2002.

Microsoft, Comcast, Joost and others to make its programs available “all over the web.”<sup>51</sup>

Local stations must fear such announcements.

Time Warner President Jeff Bewkes said it is just a matter of time before networks make all their programs available to MVPDs for VOD.<sup>52</sup> Time Warner is a major supplier of network content as well as the nation’s second-largest cable system operator, with over 13 million subscribers.

### **HDTV ADDS TO EXPENSES**

Congress has mandated that all over-the-air television be provided digitally by Feb. 17, 2009. The expense to local television stations has been significant. Overhauling a station (including transmitters, monitors, cameras – virtually every piece of equipment in the video chain) costs millions.<sup>53</sup> The costs for a transmitter are the same whether a station is large market or small so the expenses are nearly the same, yet the revenue potential is significantly different. As with other market realities, it is easier for larger market stations to finance the added expense while small market stations are more strained.

### **STATION RESPONSES IN THE TWENTY-FIRST CENTURY**

To maintain profitability, local stations have had to find some way to make up for the lost network revenues and increasing operational costs. To reduce costs, they have

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<sup>51</sup> P. Bond, “Web Video Attracting Broad Band,” *Hollywood Reporter*, June 12, 2007.

<sup>52</sup> “Resistance to Cable VoD is Futile, Time Warner Chief Tells Networks,” *Television A.M.*, June 1, 2007.

<sup>53</sup> In 1999, the costs for just an antenna, tower and transmitter alone were \$2-5 million. H. Lindsey, “HDTV Conversion,” *TFM* (Newsletter of Broadcast Cable Financial Management Assn.), Feb/March, 1999. Camera costs may have declined but not transmission costs. NTIA still estimates over \$3 million for an HDTV transmission system. [http://www.ntia.doc.gov/ptfp/application/EquipCost\\_TV.html](http://www.ntia.doc.gov/ptfp/application/EquipCost_TV.html)

centralized operations and increased automation, where one station can actually handle the programming for six.<sup>54</sup>

On the income side, by far the most lucrative of the new revenue streams for local stations has been retransmission agreements. Since 1993, local stations have had the opportunity to charge for the carriage of their signals but initially did not. “Balance of power” issues and uncertainty of the new system meant that most stations either opted for must carry or imposed relatively minor expectations on cable systems, such as the addition of a second channel for local weather. As new delivery technologies have been developed, stations have been able to demand retransmission fees,<sup>55</sup> which has resulted in increased pressure on existing MVPDs to pay. With each subsequent three-year negotiating cycle, stations appear to be able to extract more from cable systems.<sup>56</sup> In 2006, Nexstar Broadcasting announced retransmission agreements that would result in a total of \$48 million of revenue for its 47 television stations.<sup>57</sup> There has been a “huge rise” in interest by investors in television stations, largely driven by new retransmission consent revenue streams.<sup>58</sup>

In a rather creative move, Sinclair Broadcasting tried to negotiate retransmission consent for all its stations unilaterally, telling cable systems that the price was the same for popular stations (affiliated with larger networks) as for the less popular ones. Cable systems might have simply elected not to carry the less popular one, except Sinclair insisted that it would only provide the channels to cable systems that agreed to carry all

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<sup>54</sup> J. Luff, “Centralcasting Solutions,” *Broadcast Engineering*, July 1, 2003.

<sup>55</sup> D. Rehr, “Stations a Basic Backbone,” *Multichannel News*, Jan. 29, 2007.

<sup>56</sup> A 2002 report from the American Cable Association outlined a number of techniques broadcasters had used in negotiating to shift the balance of power, which the ACA characterized as “retransmission consent abuse.”

<sup>57</sup> “Nexstar Broadcasting Completes Retransmission Consent Agreements Which Will Generate Approximately \$48 million in Revenue,” *Business Wire*, Feb. 1, 2006.

<sup>58</sup> “Investment Funds Pursue Station Purchases, Snag Clear Channel Deal,” *Television A.M.*, Apr. 23, 2007.

of them.<sup>59</sup> Sinclair attempted to use its stronger channel to shift the balance of power so that its smaller stations had the clout of larger ones. The negotiation and subsequent legal wrangling garnered quite a bit of media attention. Sinclair has been one of the more blunt broadcast groups, stating that retransmission consent fees have “replaced the steady decline in revenues from television network compensation.”<sup>60</sup>

Broadcasters see digital television as both an expense and as a potential source of new revenue. Rather than providing a single video stream as they do now, DTV allows broadcast of four different video signals. One of those signals could be the current offering but the others might carry channels for news, weather, shopping or movies (either for free or descrambled for subscribers only).<sup>61</sup> Of critical importance for the success of these channels is carriage by multichannel video providers (most notably cable and satellite). This issue will be examined in greater detail later in this paper.

## **OTHER PROGRAM PROVIDERS**

Not all programming comes from networks. In addition to locally produced programs, stations obtain content from program syndicators. Some of the content is new (like *Jeopardy* and *Oprah*) while some is content originally aired on networks and now rerun (like *Everybody Loves Raymond* or *Seinfeld*). Stations negotiate with syndicators for this programming. Of course group-owned stations often negotiate for all of their stations simultaneously to get the best deal.

While some programming is sold on a simple cash payment system, most syndicated programs are sold as “cash plus”: the syndicator receives a payment for the

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<sup>59</sup> “Cable Company Sues Sinclair on Carriage Bullying Allegations,” *Television A.M.*, Oct. 10, 2006.

<sup>60</sup> L. Moss and M. Farrell, “Dueling for Dollars,” *Multichannel News*, March 5, 2007.

<sup>61</sup> “Broadcasters Testing Many Paths with DTV Multicast Channels,” *Television A.M.*, May 19, 2006.

program but also keeps some of the advertising time to sell. The result makes the negotiations more complicated. If a station is willing to schedule a program at a time when more television sets are on the syndicator has a larger potential audience for the advertisements, so the syndicator might accept a lower cash payment than if the show were scheduled at a less popular hour. Syndicators also consider the ratings of the “lead-in” programs knowing that many of the viewers will continue watching through sheer inertia.

Program exclusivity also figures into the cost of programming. Many of the first-run programs guarantee that stations buying the program will be the only source for the show within their DMA, regardless of delivery method. For example, WABC in New York has an exclusive agreement with King World for *Oprah*, and Manhattan Cable would be prohibited from bringing in any other channel carrying the program. On the other hand, WNYW has a non-exclusive agreement with Sony Television for *Seinfeld*, so customers of Manhattan Cable can see the program not only on WNYW, but also on TBS.

## **A Summary of Comments and Rulings Related to Retransmission**

### **Consent and Must-Carry**

#### **Background**

In the early years cable television, then termed CATV, faced a significant number of federal regulations. The perception was that cable was a hindrance to free speech since it threatened the viability of over-the-air broadcasting, particularly of smaller stations. Further, in most areas, cable was proven to be a natural monopoly since there was little if any competition for the delivery of distant broadcast signals or non-broadcast programmers such as HBO, ESPN, and their ilk. To that end, both the FCC and Congress set cable ownership and rate regulations in place to protect consumers and program suppliers from unfair and unethical business practices on the part of the large MSOs. Today, of course, many of these Acts and Regulations have been changed and relaxed as cable providers face increasing competition from DBS, Telcos, the Internet and other multi-channel sources.

The FCC's First Report and Order on CATV was the beginning of what was then termed the Carriage Rule, now "must-carry."<sup>62</sup> In these days must-carry benefited both the cable industry and broadcasters, especially the UHF stations which suffered from reduced signal strength and clear reception in the outlying regions of their respective markets. Cablecasters likewise benefited from the must-carry rules since they were provided a free source of quality programming, including some from the major networks that depended on UHF stations for distribution.

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<sup>62</sup> FCC First Report and Order, 38 F.C.C 683 (1965)

But, as cable penetration increased, cable operators began to perceive must-carry as a burden since many of the must-carry signals were from less well funded independent stations with commensurately weaker programs. Although twice the federal Courts of Appeals ruled the must-carry rule unconstitutionally infringed on cable operators' First Amendment rights, the decisions were narrowly tailored and the rule continued with some limitations and left the door open for the FCC to justify their actions.<sup>63</sup> Then, in the 1992 Act, Congress addressed the issue creating the "must carry" rules as a statutory amendment to the Communications Act, and saying that broadcasters could choose either must-carry or negotiate with cable operators on the terms of carrying their signals.<sup>64</sup> However, Turner Broadcasting challenged these new rules.

The Supreme Court's Turner Broadcasting System v. FCC decision in 1994 declared the must-carry rules to be content-neutral and asked the lower court to review their constitutionality. The Court of Appeals decided the rules met constitutional standards and the Supreme Court agreed in 1997.<sup>65</sup> The Court's 5 to 4 majority in essence said that content neutrality was maintained because the rule simply favored over-the-air broadcasting over pay cable to prevent the demise of the broadcast industry but without regard to the programming content. However, the Court's narrow decision lends credence to the suggestion that it deserves reconsideration by Congress.

While this was still in the courts, a statement was released by the FCC in November of 1996 in which they pointed out that the Communications Act of 1996 prohibits cable operators and other multichannel video programming distributors

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<sup>63</sup> See *Century Communications Corp. v. FCC*, 835 F.2d 292 (D.C. Cir 1987); *Quincy Cable TV. V. FCC* 768 F.2d 1434 (D.C. Cir. 1985).

<sup>64</sup> Pub. L. No. 102-385, 106 Stat. 1460

<sup>65</sup> *Turner Broadcasting System, Inc. v. FCC* 910 F Supp. 734 (D.D.C 1995)

(MVPDs) from receiving and distributing commercial television, low power television and radio broadcast signals without first obtaining the broadcasters' consent (§614).<sup>66</sup> The common term for this is "Retransmission Consent," and may include compensation from the cable operator to the broadcaster for the use of the station's signal. Must-carry rules are the alternative; they can require a cable operator that serves the same market as the broadcaster to carry the broadcaster's signal. However, if must-carry is invoked, the broadcaster is precluded from requiring compensation. As it stands, every three years the broadcaster is obliged to choose whether to require must-carry or retrans.

For the broadcaster the trade-off is usually that under must-carry provisions, the cable operator generally has to, at the broadcaster's option, locate the station either on their on-air channel number or on the channel number where they were previously carried by the cable system. If the broadcaster selects retransmission consent, the cable operator is required to provide some form of compensation to the broadcaster. This may take the form of cash payments, carriage of another programming service provided by the station, or promotional efforts on other signals carried by the system, or some combination of these. In reality, the largest percentage of stations opt for retransmission consent and only the smaller stations, LPTV and some others, select must-carry.

Starting in the late 1980s, the FCC began investigation of the issues regarding the potential for digital broadcasting. Their first major action was the creation of a group of manufacturers called the Grand Alliance in 1993.<sup>67</sup> The task given the Grand Alliance was the creation of digital television standards.

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<sup>66</sup> Cable Television – Fact Sheet – FCC, 11/1996

<sup>67</sup> Fourth Further Notice of Proposed Rule Making – FCC 95-315

In May 1993, the proponents of four all-digital systems formed the Digital HDTV Grand Alliance. The members of the Grand Alliance were AT&T (now Lucent Technologies), General Instrument, North American Philips, Massachusetts Institute of Technology, Thomson Consumer Electronics, the David Sarnoff Research Center (now Sarnoff Corporation) and Zenith Electronics Corporation. After a thorough review of the Grand Alliance's proposal, the FCC's Advisory Committee ordered a number of important changes, and the Grand Alliance companies proceeded to build a final prototype system based on specifications approved by the Advisory Committee.<sup>68</sup>

Next, the FCC rolled out a plan for the gradual transition from analog to digital transmission of television programming in 1997. Initially, January of 2006 was to be the date for full conversion from analog to digital television in the United States.<sup>69</sup> Subsequently, Title III of the Deficit Reduction Act of 2005 set February 17, 2009 as the date on which full-power TV stations must cease all analog television broadcasts in favor of digital-only broadcasting – signals which analog TV sets will not be able to receive.<sup>70</sup> Even with the later date there is still the caveat that if fewer than 85% of homes in a given market have digital receivers or converters, local stations in that market may continue to broadcast in an analog format.

Another part of the Communications Act of 1996 gave a second channel to broadcasters to ease the digital broadcasting transition. Congress envisioned television stations would return their original analog frequencies to the FCC. However, cable operators have been concerned by the FCC's implicit requirement of providing both

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<sup>68</sup> Advanced Television Systems Committee, Inc. *The Grand Alliance*, [www.atsc.org](http://www.atsc.org).

<sup>69</sup> Advanced Television Systems and Their Impact Upon Existing Television Broadcast Service, Memorandum Opinion and Order, FCC 98-24, MM Docket No. 87-268 (Feb. 23, 1998)

<sup>70</sup> P.L 109-171

analog and digital channels during the transition period.<sup>71</sup>

According to broadcasters, 65 percent of homes in the U.S. subscribe to cable. Therefore, if cable systems don't carry digital signals, consumers won't have much reason to purchase digital receivers or converters. And, if that happens, the FCC will be stuck with maintaining two incompatible broadcasting spectrum allocations. However, understandably, cable operators don't want to be required to add additional capacity for the duplicated analog and digital signals with the same programming content.

### **Retransmission Requirement for Ratings Sweeps?**

Starting in 1993, Time Warner carried the ABC Stations on its cable systems pursuant to a retransmission consent agreement entered into between Time Warner and ABC an agreement which expired on December 31, 1999. Subsequently, Time Warner and ABC entered into at least five extensions of varying duration of the original retransmission consent agreement to permit continued carriage of the ABC Stations on Time Warner's systems. At the time ABC filed its petition, the last of these extensions had expired at midnight on April 30, 2000 and Time Warner ceased carriage of the ABC Stations on its cable systems, On May 1, 2000, ABC filed an Emergency Petition for Declaratory Ruling and Enforcement Order requesting the FCC to order Time Warner Cable to immediately comply with the provisions of Section 76.58 of the Commission's rules.<sup>72</sup>

ABC asserted that, because the then current retransmission consent extension with Time Warner expired on April 30, 2000, four days after the commencement of the May

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<sup>71</sup> Hopkins, W. Wat, ed. Communication and the Law (Northport, AL, Vision Press, 2007), p. 213.

<sup>72</sup> *FCC Finds Time Warner Cable in Violation of "Sweeps" Rule*, FCC News, May 3, 2000.

2000 sweeps period, Time Warner was expressly precluded by Section 76.58 from deleting the ABC Stations from its systems until the current sweeps period ended on May 24, 2000. Section 76.58 sets forth the mandatory carriage, or must-carry, obligations of cable operators: "No deletion or repositioning of a local commercial television station shall occur during a period in which major television rating services measure the size of audiences of local television stations."<sup>73</sup>

Time Warner argued that where a station elects retransmission consent rather than must-carry, Section 325(b)(1)(A) of the Communications Act provides that no cable operator shall retransmit the signal of a television station except with the express authority of the originating station. Time Warner contended that, without a further extension of the retransmission consent agreement, which did not occur prior to midnight April 30, 2000, Time Warner ceased to have any ability or obligation to carry the ABC Stations' signals and therefore dropped their signals.

In adopting rules to implement the Communications Act, Time-Warner expressed the opinion that they believed the Commission addressed and effectively resolved the interpretative issue raised by ABC. In analyzing the impact of certain provisions of Section 614, particularly the obligation to "carry the entirety of the program schedule of any television station carried on the cable system," on the carriage of local television signals by cable operators through retransmission consent, the Commission concluded that the entire program schedule obligation had "applicability to more than just television signals carried pursuant to the must-carry rules." The Commission stated that the plain language of the Act required cable operators to "carry the entirety of the program schedule of any television station carried on the cable system unless carriage of specific

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<sup>73</sup> Ibid.

programming is prohibited, and other programming authorized to be substituted" applies to retransmission consent stations as well as must-carry stations. The Commission concurred with ABC and directed Time Warner to continue carriage of the ABC stations until the end of the sweeps period.<sup>74</sup>

### **The Satellite Issue**

Although a discussion of satellite providers may appear tangential, their role in the media mix is instructive. Satellites are, of course, essentially "cable without wires," having certain technological advantages and handicaps. However, as MVPDs and traditional competitors, the approach taken by the FCC in rule-setting could ultimately be a harbinger for the cable industry.

In November of 1999, the FCC launched proceedings to implement the Satellite Home Viewer Improvement Act (SHVIA) passed by Congress earlier that year. This law permitted satellite carriers to transmit local television broadcast signals into local markets. The legislation sought to place satellite carriers on an equal footing with local cable television operators when it came to the availability of broadcast programming, and thus give consumers more and better choices in selecting an MVPD.

The SHVIA outlined numerous tasks for the FCC, among other things the law required the Commission to establish rules for satellite companies in regard to mandatory carriage of broadcast signals, retransmission consent and program exclusivity. Under this law, before a local television broadcast signal could be delivered into a local market, the satellite carrier had to obtain the retransmission consent of the local broadcaster.

The SHVIA also prohibited broadcasters from entering into exclusive retrans

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<sup>74</sup> Ibid.

agreements and required broadcasters, until January 1, 2006, to negotiate in good faith with satellite carriers and other MVPDs with respect to the broadcasters' signals.

Then in March of 2000, the FCC amended the SHVIA rules to provide for good faith negotiations and exclusive agreements for retransmission consent involving TV stations and cable or satellite companies. The FCC established a two-part test for these good faith negotiations and prohibited exclusive retransmission agreements that were negotiated before January 1, 2006.<sup>75</sup>

The first part of the two-part “good faith” test consists of a brief, objective list of procedural standards applicable to broadcast stations negotiating retransmission consent agreements. These Standards state:

- 1) A broadcaster may not refuse to negotiate with an MVPD;
- 2) A broadcaster must appoint a negotiating representative with the authority to bargain;
- 3) A broadcaster must agree to meet at reasonable times and locations and cannot delay the course of negotiations;
- 4) A broadcaster may not offer a single, unilateral proposal;
- 5) In responding to an offer proposed by an MVPD, a broadcaster must provide reasons for rejecting any aspects of the offer;
- 6) A broadcaster is prohibited from entering into an agreement with any party conditioned upon denying retransmission consent to any MVPD; and
- 7) A broadcaster must agree to execute a written retransmission consent agreement that sets forth the full agreement between the broadcaster and the MVPD.

Under the second part of the “good faith” test, an MVPD may present facts to the

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<sup>75</sup> FCC - SHVIA FACT SHEET – November, 1999

FCC which, even though they are not a specific violation listed above, given the totality of the circumstances constitute a failure to negotiate in good faith. However, the SHVIA adds that assuming the television broadcast station enters into retransmission agreements containing different terms and conditions, and if agreements are based on competitive marketplace considerations, it shall not be considered a failure to negotiate in good faith. The FCC concluded that it is impossible to objectify competitive marketplace factors that broadcasters must use in negotiating.<sup>76</sup>

In 2004, the FCC updated the SHVIA with the Satellite Home Viewer Extension and Reauthorization Act (SHVERA). Neither of them requires satellite companies to offer local channels. Rather, satellite companies have the option of providing local station service.<sup>77</sup>

A satellite company that has chosen to provide this local station service is required to provide subscribers with all of the local broadcast TV stations assigned to that DMA that have asked to be carried. A satellite company is not required to carry more than one local broadcast TV station within the DMA that is affiliated with a particular TV network in the same state. Local PBS stations and other noncommercial stations are usually included in the "local" stations offered in areas where the satellite companies choose to offer local station service.

The 1992 Cable Act required the FCC to establish some public interest obligations of satellite programming operators including rules regarding political communication, retrans (though not must-carry) and Equal Employment Opportunity.<sup>78</sup>

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<sup>76</sup> Ibid.

<sup>77</sup> FCC – Satellite Home Viewer Extension and Reauthorization Act, 2004.

<sup>78</sup> Implementation of Section 25 of the Cable Television Consumer Protection and Competition Act of 1992, 8 F.C.C.R. 1589 (1993).

In general, if a satellite carrier offers local station digital signals, it is not permitted to offer distant digital signals, unless customers were receiving distant digital signals as of December 8, 2004. At this writing, local digital signals are offered only in a limited number of areas. Although satellite subscribers who are "unserved" with respect to analog service are eligible for distant digital signals, satellite companies are not required to offer distant digital signals.<sup>79</sup>

### **Current Issues**

In January of 2006, Robert G. Lee, General Manager of WDBJ, spoke at a hearing of the Senate Commerce, Science and Transportation Committee on behalf of the NAB. His feeling was that broadcasters are singled out to receive no compensation from MVPDs. He said that MVPDs complain that broadcasters are unreasonable in negotiating cash payment for carriage of local signals but also claim that negotiating for the carriage of additional programming is likewise unreasonable. At the same time he pointed out that all other programming suppliers do receive compensation.

Lee said that given the "rapidly increasing competition between MVPDs and broadcasters for national and local advertising revenue" the broadcasters are handicapped. He explained, "Congress concluded that public policy should not support 'a system under which broadcasters in effect subsidize the establishment of their chief competitors.'" He defended his position noting, "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

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<sup>79</sup> Ibid.

signals. In its September 2005 report to Congress, the FCC concluded that the retransmission consent rules did not disadvantage MVPDs and have in fact fulfilled Congress' purposes for enacting them." He finished by saying "retransmission consent has fulfilled Congress' purposes for enacting it, and recommended no changes to either statutory or regulatory provisions relating to retransmission consent."<sup>80</sup>

Recently the NCTA, which until this point remained neutral, has taken the position that they need to become involved in the retrans controversy. The catalyst for this position change is the recent experience of Mediacom Communications and SuddenLink, two of NCTA's smaller system members.<sup>81</sup> These two cable systems fought with TV station groups over retrans fees and each lost its fight.

NCTA President Kyle McSarrow has taken the position that their association "should always be champions of the free market." He said that "their board, however, believes the issue is broader than just retrans, it also includes the issue of carriage, including must-carry... But at the end of the day broadcasters and the cable industry need each other."<sup>82</sup>

McSarrow continued by saying that he's been telling Congressional members the current regulatory climate was created in 1992 but the industry has experienced dramatic change in cross-platform competition regarding programming since then. "It's a little

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<sup>80</sup> Statement of Robert G. Lee, GM, WDBJ Television, Roanoke, VA On Behalf of the National Association of Broadcasters Hearing before the Senate Commerce, Science and Transportation Committee, January 31, 2006.

<sup>81</sup> "Retransmission Consent Reform: Not So Fast," from TV Newsday, June 12, 2007 (www.freepress.net/news/print/23823).

<sup>82</sup> Ibid.

anachronistic (to assume) that without must-carry, for example, the very survival of the broadcast industry is at stake.”

McSlarrow sees it as “vital” that all the parties, including the consumer electronics people, deliver “a consistent message” that the transition to digital will come and that the combination of media purveyors can provide what is necessary and desirable.<sup>83</sup> He concluded by saying that cable’s customers need the transition to feel seamless. He says that in his opinion the FCC doesn’t need to make new rules for that which is in the best interest of the cable industry. However, since the FCC is proceeding with writing rules, it’s critical that the rules are written right.

A 2007 congressional proposal currently under consideration is the Television Freedom Act which would allow cable operators to import TV signals from adjacent DMAs particularly in areas where those DMAs cross state lines. The FCC would have to revise its network nonduplication, syndex, and sports blackout rules to accommodate the change.<sup>84</sup> Under current rules, cable systems are prevented from importing distant signals into markets where customers can get a viewable signal from a local station carrying the same programming. “However, because so many of the DMA boundaries cross state lines, millions of subscribers are left watching the local channels of their neighboring state,” said the bill’s co-sponsor Rep. Mike Ross.

American Cable Association President Matthew Polka supported the bill saying: “The ACA applauds Reps. Mike Ross .. and Barbara Cubin for introducing this bipartisan legislation that expands consumer access to in-state broadcast stations.” One example

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<sup>83</sup> Ibid.

<sup>84</sup> New Bill Would Allow Distant TV Signal Importation, Eggerton, John, Broadcasting & Cable, 6/21/2007

cited of a DMA that crosses state lines to the detriment of some viewers occurs in the Memphis DMA. Some viewers live in Arkansas (Ross' legislative district) and are deprived of Arkansas Razorback football as a consequence of the current regulations.<sup>85</sup>

The NAB, however, is currently taking a “wait and review” position.” They have issued a statement saying the “NAB would have serious concerns with any legislative attempt to disrupt the concept of localism...”<sup>86</sup>

### **Finding Common Ground**

The paradigm for program distribution is constantly evolving. As Heraclitus said in 513 BC., “There is nothing permanent except change.”<sup>87</sup> With the growing shift toward Internet distribution at the top of the list, the landscape needs constant care to protect the vested interests of consumers, MVPDs, broadcasters, satellite providers, programming sources, equipment manufacturers, and others. These disparate entities are forced by economics to resolve their differing priorities. Sometimes Congress and the FCC are an aid to resolving these differences and sometimes a hindrance, a determination that frequently reflects the viewpoint of the group making the observation.

Fortunately, the major players in the field all appear to understand that cooperation is the only solution. The statements of McSparrow and others in the industry have been positive signs of this cooperation in recent months.

Other encouraging signs are, for example, the fact that the CBS Corporation has reached comprehensive retransmission consent agreements with nine separate cable operators covering more than one million subscribers nationally. All of the agreements

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<sup>85</sup> Ibid.

<sup>86</sup> Ibid.

<sup>87</sup> Bartlett, John, Familiar Quotations, *Heraclitus*, 1955.

include analog, digital, multicast and high-definition rights to programming on CBS owned-and-operated television stations.

"We're pleased to have forged these long-term, forward-looking partnerships with so many cable operators," said CBS President Les Moonves, "Clearly there is a new paradigm in the marketplace -- one that recognizes the value of the content that we bring to our various audiences. This is a trend that bodes well for us going forward as future retransmission deals are negotiated." Terms of the agreements were not disclosed.<sup>88</sup>

In another example Comcast Corp. and Sinclair Broadcast Group Inc. have agreed on a four-year extension of their analog and digital carriage agreement. Comcast said that the agreement is for the continued carriage of both the analog and digital signals of 37 stations in 23 markets owned or operated by Sinclair, an agreement which will expire on March 1, 2011.<sup>89</sup>

One of the most ambitious, and apparently altruistic, efforts is the "Save Our Sets Coalition" (SOS) plan sometimes referred to as the "Massillon (OH) Plan" which was enunciated in June of 2007.<sup>90</sup> The *Save our Sets* proposal was spurred by the U.S. Government's plan for transition to digital TV. Under the plan the government would provide consumers with up to two \$40 vouchers (assuming the program is policed and administered) toward the purchase of approved digital-to-analog conversion equipment starting in January 2008. These vouchers would let householders buy set-top boxes from cable companies that would allow them to convert the digital signals to their existing analog receivers.

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<sup>88</sup> PRNewswire-FirstCall, Feb 22, 2007

<sup>89</sup> Reuters, March 9, 2007

<sup>90</sup> *A No-Cost Transition?* [Multichannel News](#), 6/25/2007

The government's plan, however, may not fund enough vouchers to provide for everyone likely to apply, says Massillon Cable counsel Mark Palchick. According to the Save Our Sets Coalition, launched by Massillon's Bob Gessner, the Government plans to issue 33.5 million vouchers on a first-come-first-served basis. They argue the vouchers will be for boxes that will cost more than \$40, will have limited functionality, and will convert over-the-air signals from digital to analog on one television receiver only. Further, they say there will not be enough coupons to solve the problem.<sup>91</sup>

More recently, Congress has debated whether to supply free set-tops for all 73 million broadcast-only TV sets or to fund a just few million boxes for low-income households.<sup>92</sup> The debate is still not settled at this writing. Fred Upton, (R-Mich) who helped design the government's plan has stated that the predicted demand will not exceed the supply which would provide for the proposed 22.25 million converters.<sup>93</sup> FCC Commissioner Jonathan Adelstein, however, appeared to recognize the issue of limited vouchers, stating: "At the end of the day, the FCC's approach may lead to higher cable prices. And it doesn't advantage the digital transition in any meaningful way."<sup>94</sup>

By contrast, under the *Save our Sets* plan, an analog television household that meets certain requirements would be eligible to continue receiving the same analog signals they received free over-the-air from their local TV stations prior to the transition for free for another 7 years after the transition from participating local cable, satellite, or other multi-channel video provider. Consumers would be able to do this without having to purchase a converter box or new digital TV set. This program would

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<sup>91</sup> *Save Our Sets*, The S.O.S. Coalition, Public Relations release. 2007.

<sup>92</sup> Broadcasters Seeking Specs for Set-Tops - By Ted Hearn -- *Multichannel News*, 6/15/2005.

<sup>93</sup> *No-Cost Transition?* Multichannel News, 6/25/2007

<sup>94</sup> Adelstein, Jonathan, - FCC Commissioner Adelstein's Remarks for ACA/NCTC Independent Show Luncheon, closed circuit transmission, 8/17/07, [www.americancable.org](http://www.americancable.org)

be an addition and enhancement to, but not a replacement for, the federal government's current converter box coupon program. If the TV set owner is not a current customer of the MVPD, the company will also hook up all the consumer's receivers for free.

Meanwhile, local TV stations would be guaranteed distribution of all their channels, both analog and digital for seven years. However, local TV stations would have to agree that in exchange for cable's commitments, they would refrain from seeking cash or other forms of compensation for cable carriage of their signals for the seven-year period. The Massillon plan further stipulates that only homes receiving these coupons would be eligible for the free cable service.

In exchange for the seven years of no retransmission consent requirement, the cable systems would have to agree to distribute each TV station's primary video signal in both analog and digital formats. Further, each station's multicast digital services – if offered free to the public – would also have automatic free carriage on the cable system.

To meet Massillon's projected shortfall of coupons, *Save Our Sets* further proposed that the cable companies would then return the coupons to the government with the intent that the government recirculate the coupons to meet the demand.<sup>95</sup> The Massillon Cable Company has sent this proposal to the FCC.

During an August, 2007 conference, independent cable operators agreed that they need to have input in the digital-TV transition, but they are not in agreement yet on their approach. "While our role is not defined and we seem unwilling or unable to define it for ourselves, there are forces at work that are trying to define our role for us," said Bob Gessner, president of Massillon Cable and NCTC chairman. "If we don't define our role, someone else is going to define it for us, and it will be to our detriment rather than our

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<sup>95</sup> *Save Our Sets*, The S.O.S. Coalition, Public Relations release. 2007.

benefit,” he added, referring to the FCC and the NAB. They are concerned that there will be a sunset on the opportunity to take advantage of that digital transition.<sup>96</sup> The group also says the broadcast industry wants the average household to pay an additional \$10 to \$20 per month extra to continue to receive the local broadcast programming that Americans have come to expect to be provided without charge.

“The first step is getting consensus among independent operators about what is the best solution,” said Patrick Knorr, ACA chairman and general manager of Sunflower Broadband.<sup>97</sup> He went on to say that some independent cable operators have expressed concerns about the *Save our Sets* plan, namely the cost and maintenance of hooking up nonpaying customers. According to Knorr, the ACA has communicated with Congress and the FCC on the digital transition and it also seeks to meet with the Consumer Electronics Association. “There are several proposals that we are looking at as an organization to work on behind-the-scenes,” he said. “We are working on getting cable’s voice heard.”<sup>98</sup>

Some cable operators have also voiced additional concerns about the digital transition in 2009: specifically that some would not be able to receive digital signals from TV stations over the air in remote cable systems, and that there are no standards to convert a broadcaster’s HD digital signal to standard-definition.

Commissioner Adelstein speaking to the August conventioners said: “Because video is becoming so much more competitive you (the cable industry) know the needs there. But there are also opportunities on the voice side of the equation, and they present

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<sup>96</sup> <http://www.saveoursets.com>

<sup>97</sup> Moss, Linda, “Executives from Small Operators Talk Strategy at Independent Show Breakfast.” Multichannel News, 8/1/2007

<sup>98</sup> Moss, op cit.

real bright spots for your business to grow and remain strong. Cheaper voice services and triple-play bundles are attractive to consumers and can serve as the new ‘killer app’ to help you meet the needs of consumers.<sup>99</sup>

Adelstein also made a plea to other FCC commissioners and the cable industry for its member companies to be more invaluable to consumers. He went on record saying: “The Commissions’ failed to use its authority to promote the consumer outreach and education component of the DTV transition, and that’s an area where Congress clearly expected us and the cable industry to coordinate and take action.”<sup>100</sup>

Ultimately, it seems apparent that as new MVPDs vie with Telcos, satellite providers, and the Internet for customers, the industry faces increased financial and regulatory challenges. Broadcasters seem to be aware of the economic demands of the cable marketplace and aware that must-carry may be dropped. Further, the fact they are choosing retrans supports the thesis that, except for the smaller stations, they don’t need must-carry. The largest percentage of stations today opt for retransmission consent anyway and only the smaller stations, LPTV and some others, select must-carry. Regardless, on the horizon there seems to be an awareness that the many players involved in traditional television delivery modes will need to work together to find ways to compete without alienating viewers and government.

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<sup>99</sup> Adelstein, Jonathan, *op. cit.*

<sup>100</sup> *Ibid.*

## **Retransmission Consent Agreements and Small Cable Companies**

Since the Telecommunications Act of 1992 authorized retransmission consent agreements most local network affiliates have chosen the option over the must-carry option.<sup>101</sup> Under retransmission consent agreements local network carriers sell network programming to local cable providers. The terms of the contract are subject to negotiation between the two parties. From an economic perspective such retransmission consent agreements are a classic case of bi-lateral bargaining “game” between two price searchers.<sup>102</sup> Economic analysis has traditionally focused on the “efficiency” implications in such a setting. If the value the buyer (the cable company) places on the bundle of services (local network affiliate’s program content) exceeds the opportunity costs to the seller (the network affiliate) of providing the bundle of services then a mutually beneficial and an efficient exchange is possible.

Given the likely high value of local network based programming to cable consumers and the relatively low cost of transmitting the network signal, it is reasonable to assume that on the whole such transactions are efficient. If such an apparently efficient transaction is not occurring it must be because of what economist describe as transaction costs. The economic question then becomes what is the nature of these transactions costs that are precluding the exchange from occurring? The policy question becomes is there anything in policy that can reduce those transaction costs and facilitate additional efficient exchanges?

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<sup>101</sup> See Lubinsky, Charles (nd) “Reconsidering Retransmission Consent: An Examination of the Retransmission Consent Provision (47 U.S.C. 325(b)) of the 1992 Cable Act” p.23. Downloaded at <http://www.law.indiana.edu/feli/pubs/u49/no1/lubinsky>

<sup>102</sup> See Chae, Suchan (1998) “A Bargaining Model of Retransmission Consent and Must-Carry Rule” Information and Economic Policy 10 369-387.

Although there have been a number of cases where network affiliates and cable providers have failed to reach agreement, so that cable viewers have been denied cable access to local network affiliate programming<sup>103</sup>, these cases are the exception not the rule. Typically large broadcast conglomerates engage other large cable systems in extensive often contentious but ultimately fruitful negotiations.<sup>104</sup>

There is second component of this bi-lateral bargaining game: how are the gains from the transactions apportioned between the two parties? Two lines of inquiry are apparent: the scientific question of predicting how much each party will obtain, and the non-scientific normative question of whether such a distribution is equitable. The primary job of the economist is to predict how gains will be split up given the nature of the parties involved in the transactions and the institutional arrangements implicit in the negotiating process. Although economic analysis has no way of evaluating the “fairness” of a transaction, the economic analyst can allude to established social notions of fairness and compare them to the predicted distributional outcome.

Unlike the economic notion of efficiency which is a relatively straightforward and singular concept, there is no single social norm as to what distribution of gains is equitable. Nevertheless, this chapter will offer a very loose normative notion based on research from the burgeoning field of experimental economics.

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<sup>103</sup> See for example Dave Hendricks (2007) “Sinclair inks retransmission agreement with Cox” June 5, 2007. Downloaded at <http://www.sn1.com/interactivex/article.asp?CDID=A-5844437-1105Printable=1>.

<sup>104</sup> See Gershom, Richard A and Bradley M. Egan (1999) “Retransmission Consent, Cable Franchising and Market Failure: A Case Study Analysis of WOOD-TV 8 versus Cablevision Michigan” Journal of Media Economics 12(3) 201-224.

In an economic experiment human subjects are isolated in a controlled laboratory setting. They are given monetary rewards for certain, usually interactive behaviors. These behaviors are directed by the “game” the participants are directed to play.

One well-known and extensively researched game is the ultimatum game. In such a game two individuals, who do not know one another, are paired. One individual is the “proposer” while the other individual is the “responder.” The proposer and responder are not allowed to directly collaborate before or during the game, nor are they informed as to the nature of the game beforehand. The pair is given access to a fixed sum of money, say \$100. The proposer offers a split of the \$100. If the responder agrees to the split the money is allocated accordingly. If, on the other hand, the responder rejects the proposal both parties leave with no reward.

There are a set of general results that emerge from the numerous experiments in the ultimatum game. First, most proposers do offer splits that are in their own favor, but not excessively. A \$60-\$40 split is common, while a \$95-\$5 is not. Responders uniformly accept the offers of proposer except when the offers are low: responders almost always accept the \$60-\$40 split; but will in many if not most cases reject the \$95-\$5 split. (Note that this implies the responders are turning down a positive sum of money!) Responders typically reject proposals when they are offered less than 20% of the total payout.<sup>105</sup>

What does this say about social norms of distribution? First, that most proposers do not offer extreme splits is evidence that they find them either ethically unacceptable or view them as untenable. Second to the extent that responders often reject extreme splits implies that not only do they find such splits objectionable, but are willing to pay a price

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<sup>105</sup> See Levitt, Steven D. and John A. List (2007, p.155) “What do Laboratory Experiments Measuring Social Preference Reveal about the Real World?” Journal of Economic Perspectives 21:2 153-174.

to enforce the objection with a stranger! One is not hard pressed to conclude that taking an inordinate share of the pie—80%+ -- is outside the social norms of contemporary American society. From this one can conjecture that if a negotiating process systematically gave one party an overwhelming share (say 80%+) of the total gains, then most people would find the result untoward. A case, therefore, could be made for changing the institutional nature of the negotiation to yield a more equitable outcome.

### **Retransmission Negotiation and the FCC**

What determines the outcome of negotiation between a cable provider and network affiliate? The answer will depend crucially on the specifics of each party to the negotiation. A recent Congressional Research Service report outlined the basic economic motivation of each party quite succinctly:

“The relationship between programmer (network affiliate) and distributor (cable provider) is characterized by mutual need—the programmer needs distributors to have direct contact with the potential audience; the distributor needs programmers with good content to attract subscribers. At the same time, there is an inherent tension as each seeks to capture the lion’s share of the value that consumers place on that content”(p.8) <sup>106</sup>

The report went on the point out that local cable operators who traditionally have had local market monopolies are facing increased competition from satellite networks (such Direct TV and DISH), major telephone companies, cable overbuilders, and on-line video streams. This new market reality has, quite predictably, tilted negotiating power in favor of the content providers. (e.g. local network franchises) This is especially true for

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<sup>106</sup> See Goldfarb, Charles (July, 9, 2007) “A Condensed Review of Retransmission Consent and Other Federal Rules Affecting Programmer-Distribution Negotiations” Washington, D.C., Congressional Research Service.

owners of local network franchises that have exclusive rights to certain “must carry” programming such as major sports events or shows with large national followings. Large cable operators, such as Comcast with more than 24 million subscribers, or those with significant regional clustering are likely to weather this change in market conditions because of the size of their viewer base. However, the report points out that “small and mid-sized cable companies (have) been placed in a particularly difficult position.”<sup>107</sup>

Although FCC rules require the parties to negotiate in “good faith” the FCC has indicated reluctance to intervene in these negotiations. In the 2007 *Mediacom vs. Sinclair* case the FCC denied Mediacom’s assertion that Sinclair was not negotiating in good faith and denied Mediacom’s request for relief arguing:

“The record amply demonstrates that over the year of negotiation, there have been numerous proposals put forth by both parties and that there has been significant discourse back-and-forth on these proposals...good faith negotiations require both parties to explain their reasons for putting forth or denying an offer. In this instance, however, Mediacom appears to expand this requirement to the point that Sinclair must empirically prove that its offers are consistent with market place considerations or violate the good faith rules. Mediacom and Sinclair are sophisticated, well established media corporations that can determine for themselves whether particular proposals reflect market conditions” (p.7)

Such reluctance on the part of the FCC to intervene in negotiations in such cases as *Mediacom vs. Sinclair* is probably a reasonable policy response. Both theory and evidence suggest that bi-lateral bargaining will yield both efficient outcomes and outcomes consistent with notions of equity when the bargaining partners are “sophisticated and well-established.”—or in economic parlance both sides have reasonably equal negotiating power. Mediacom serves 1.38 million households in more

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<sup>107</sup> Ibid, p.10.

than 1500 communities.<sup>108</sup> Sinclair Media Group is one of the largest owners of local stations in the United States and has significant market reach.<sup>109</sup> As the FCC implies both have sufficient market clout and internal resources to protect their interest.

However, what can be said if there is an imbalance in negotiating power, what if a participant on one side of the transaction is neither “well-established nor sophisticated” – that is, one side has asymmetric negotiating power? One suspects the stronger party obtains an outcome in conflict with prevailing social norms.

Consider a simple case of negotiation between a small cable operator who is in negotiation with a larger network affiliate. To explore the conditions under which an imbalance occurs, we shall begin with a simple case where there is no obvious imbalance. The first two columns in Table 1 show the cable operator and the network affiliate’s financial situation before any retransmission agreement has been negotiated. Also suppose that transaction costs of negotiating are relatively low approaching zero for both parties. The cable operators expected revenue is \$250,000 its costs are \$225,000 and it expected profit is \$25,000.<sup>110</sup> The larger network affiliate has expected revenues of \$30 million, costs of \$25 million and expected profits of \$5 million.

We assume under a must carry-rule, in the absence of any transfer between the parties both parties are better off. The cable operator gains \$50,000 while the network

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<sup>108</sup> Number of subscribers to Mediacom is from Goldfarb (op.cit) , number of communities from Mediacom’s website [http://www.mediacomcc.com/about\\_us.html](http://www.mediacomcc.com/about_us.html)

<sup>109</sup> From Sinclair’s website : “Sinclair Broadcast Group, Inc. is one of the largest and most diversified television broadcasting companies in the country today. Sinclair owns and operates, programs, or provides sales services to 58 television stations in 36 markets. Sinclair’s television group includes 19 FOX, 17 MyTV, 10 ABC, 9 CW, 2 CBS and 1 NBC affiliates and reaches approximately 22% of all U.S. television households” <http://www.sbgi.net/about/profile.shtml>

<sup>110</sup> The costs and profits referred to are assumed to be economic profits compared to accounting profits. The examples imply that both firms are potentially making above normal returns on invested capital. This may be an unlikely outcome is not strictly necessary for the point but the assumption will expedite the example.

affiliate gains \$10,000 as indicated by the numbers on revenues, costs and profits in the third and fourth row of Table 1. However, let us now assume the network affiliate opts for retransmission consent. For simplicity let us assume that the contractual arrangement will take the form of a simple payment from one party to another. The most the cable carrier would be willing to pay for the network affiliates content is \$50,000; the network affiliate would pay up to \$10,000 to have its content carried by the cable operator. What will the outcome of a retransmission agreement be?

The Economic theory tells us three things:

1. If transactions costs are low enough, an agreement is efficient.
2. Without further information we have no way of knowing what the terms of the agreement will be. The “price” of the cable obtaining the network affiliate’s content could be as high as \$50,000 or as low as -\$10,000 (that is the affiliate pays the cable company to carry its content)
3. It is possible that no agreement will be reached—an outcome that is clearly inefficient—if both sides are obstinate about their share of the gain.

In this setting it is not obvious there is any particular disparity in negotiating power. Under a 50-50 split the small cable provider would pay \$20,000 to the network affiliate, generating an outcome that is both fair and efficient.

**TABLE 1**

Small Cable Operator	Large Network Affiliate
w/o agreement	w/o agreement
R= \$250,000 C= \$225,000 P= \$25,000	R= \$30,000,000 C= \$25,000,000 P= \$5,000,000
with agreement	with agreement
R= \$300,000 C= \$225,000 P= \$75,000	R= \$30,010,000 C= \$25,000,000 P= \$5,010,000
Maximum Bid= \$50,000	Minimum Ask= - \$10,000
Potential Gain: \$0-\$60,000	Potential Gain: \$0-\$60,000

Now let us modify the assumptions as indicated in Table 2. In this case let us suppose that in the absence of access to the content of the network affiliate's programming the cable operator is not viable as a business in the long-run. This is embedded in the revenue, costs and profit figures for the cable operator: without an agreement the cable operator would lose \$25,000 a year, while with an agreement without any compensation (or under a must-carry rule) the cable operator would make \$50,000 in annual profits. Note the network affiliate's financials are identical to those in the previous case.

The first conclusion garnered from the previous example continues to hold: an exchange is efficient and desirable; but the second conclusion is obviously open to modification. A profit maximizing network affiliate aware of the situation of the cable operator would offer a price of \$50,000 take it or leave it. The affiliate would be in a position to extract all the gains from the cable operator because the cable operator's existence as an economic entity is on the line. Unlike the previous case where the cable operator could credibly go without the network affiliate's content; a reality that

unquestionably enhances its negotiating position; in this case the cable operator is truly over the proverbial barrel.

**TABLE 2**

Small Cable Operator	Large Network Affiliate
w/o agreement	w/o agreement
R= \$200,000	R= \$30,000,000
C= \$225,000	C= \$25,000,000
P= - \$25,000	P= \$5,000,000
with agreement	with agreement
R= \$275,000	R= \$30,010,000
C= \$225,000	C= \$25,000,000
P= \$50,000	P= \$5,010,000
Maximum Bid= \$50,000	Minimum Ask= - \$10,000
Potential Gain: \$0-\$50,000	Potential Gain: \$0-\$60,000

A final case deserves consideration as encapsulated in Table 3. In this case all the elements are identical to the first case except that explicit costs of negotiation are incorporated into the framework: the financially healthy cable operator is assumed to have rather high transaction costs associated with negotiation. Given the size, staffing and expertise of a smaller cable provider it is unlikely the firm will have extensive and specialized skills in negotiating contracts. The small firm is likely to have to rely on a relatively expensive outside specialist to handle their negotiations. In contrast it is assumed that a larger network affiliate will have lower cost access at the margin to resources to allow it to successfully negotiate.

This points out another source of asymmetry. In this example assume the network affiliate has an expert on staff that is well versed with the ins and outs of such retransmission agreements. At the margin it is essentially costless for the network

affiliate to use them for negotiations. The small cable operator, on the other hand, faces the daunting prospect of having to bear certain and significant costs with uncertain prospects of gain. The \$30,000 costs of hiring a negotiator's services in the example cuts rather severely into the ex ante and ex post gains from negotiation for the cable operator. Surely knowledge of this asymmetry would contribute to an offer from the network affiliate that is highly biased towards the network affiliate with reasonable prospects for the acceptance from the cable operator.

**TABLE 3**

Small Cable Operator	Large Network Affiliate
w/o agreement	w/o agreement
R= \$250,000 C= \$225,000 P= \$25,000	R= \$30,000,000 C= \$25,000,000 P= \$5,000,000
with agreement	with agreement
R= \$300,000 C= \$225,000 P= \$75,000	R= \$30,010,000 C= \$25,000,000 P= \$5,010,000
Maximum Bid= \$50,000	Minimum Ask= - \$10,000
Potential Gain: \$0-\$60,000 less marginal transaction costs; assumed to be \$30,000 for negotiations	Potential Gain: \$0-\$60,000 Marginal transaction costs assumed to be zero

In conclusion the outcome of retransmission consent negotiations depend crucially on the negotiating power of the parties to the negotiation. The increase in number of outlets for major network content has tilted the balance of power toward those entities that have rights to that network content. Large or well clustered cable providers have enough market power given the size of their viewer base to be able to protect a reasonable portion of their share of the gains to retransmission negotiations. This, however, cannot be said for smaller cable operators who have never had large viewer bases and now face increased competition from alternative modes of delivery. Such

competition means that these cable operators very existence is on the line in such negotiations for must carry programming, or that they face increased transaction cost in such negotiations. It is likely that those operators are losing almost all the gains they wrest from retransmission negotiations. It is also likely that the share of gain they receive offend commonly held social norms of reasonable distribution of gains.

## **Action Alternatives**

### **EXTERNAL FORCES MAY WORK TO ACHIEVE**

#### **RETRANSMISSION CONSENT REFORM**

In addressing options to achieve a change in the current federal posture toward retransmission consent, it very well may be that acceptable solutions may be formed absent wholesale, extensive, proactive efforts by NTCA and its existing allies and members. External forces are now providing momentum for change. Some of these forces are being motivated by the desire of firms to maximize profits and to secure the best long-term regulatory/legislative environment for these firms' competitive futures. Other factors involve recent and perhaps further changes in the political landscape, as a more regulatory Congress may also be complemented by a more regulatory FCC. As such, government may soon express a greater willingness to intervene in retransmission consent disputes and to adopt regulatory measures that will work toward what some believe would be more equitable and fair negotiations. Finally, the near-term, final conversion of over-the-air broadcasting to digital technology appears to be providing an incentive for terrestrial broadcasters to reassess their use of the retransmission consent option as a "bargaining chip" as they seek comprehensive cable carriage of their digital bitstream.

As famed bank robber Willy Sutton stated when asked why he robbed banks, "because that's where the money is." Though bank robbery is not precisely what's involved in the broadcast retransmission consent arena, it is certain that profit maximization is governing broadcasters' business choices. Moreover, it is highly likely

– based on history – that parties seeking to maximize profits will chart their business plan and government policy advocacy courses in that direction. They will adopt appropriate business mechanisms and will, when necessary, seek legislative and or regulatory changes to achieve those goals.

In other sections of this report it is pointed out how new and evolving means of electronic communications are providing program suppliers, such as broadcast networks and independent producers of syndicated programming, several new paths to the viewer. That is, network television affiliates no longer are the sole – or perhaps even the desired – method for these programmers to reach the American public. Through internet distribution of Internet protocol television, any producer may reach any audience in any part of the country or the world. With options of subscription revenues coming from viewers, from intermediate providers such as local cable systems and other MVPDs, or from a hybrid of advertising and subscription revenues, there is a natural and seemingly certain move toward networks bypassing their affiliates and diminishing these affiliates' importance in the program distribution system.

As represented by this report's discussion of the end of "network compensation" and the creation of a "reverse compensation" paradigm where affiliates pay networks to carry their programming, it is not much of a theoretical leap to foresee a system where cable operators deal directly – and more efficiently – with networks to obtain network programming and distribute it to subscribers. Networks may well desire such a plan and advocate it through alterations to their business models and through complementary advocacy of changes to existing retransmission consent laws and regulations.

One historical and perhaps prophetic example is how the Fox television network, in the early years of its existence when it had relatively few affiliated stations, dealt directly with cable operators to deliver its programming to cable viewers. But even in a situation like today where the major networks each have national “reach” through affiliated stations, the concept of dealing directly with cable television systems and other MVPDs is quite attractive to networks, as well as is offering programming directly to viewers having an Internet connection.

It is undoubted that broadcast television networks, although they each have a complement of “owned and operated” stations receiving retransmission consent payments of various forms, are studying the totality of retransmission consent agreements – and payments – made across the country. With retransmission agreements garnering significant revenues for stations, these networks can only question whether the value being paid by cable operators – largely for the ability to deliver to their subscribers the network programming of affiliated stations – should be going to the networks themselves rather than to station affiliate “middlemen” who may be seen as a dispensable conduit of network programming.

As such, networks may well support a change in the statutory law that would place contract-based limitations on the ability of a local affiliate to seek and obtain retransmission consent payments – in whatever form – from local cable systems. Similar to the provisions in the current syndicated program exclusivity rules, a network might well support a revision to the 1992 Act that would condition stations’ pursuit of the retransmission consent option on the existence of specific, “exclusive distribution” language in network affiliation contracts. In this fashion networks would be a position to

secure more full value of their programming. That is, a network might charge a higher price to affiliates if they want exclusive distribution rights in their market. On the other hand, a network might well choose *not* to enter into affiliation agreements providing exclusive distribution rights to a local station. In that situation, a network could have its programming delivered to off-air viewers via the affiliated station but also have direct delivery to cable operators in the same region as well as to satellite providers. The network could negotiate a distribution fee directly with a cable operator or other MVPD – a fee likely reduced from typical, existing retransmission consent fee levels in that market.

The above scenario of statutory amendments to the 1992 Act and growing direct delivery of network programming to cable operators for distribution to subscribers is both plausible and desirable to network entities and to MVPDs. Such developments would obviate the need for NTCA and its allies to pursue concepts such as “mandatory arbitration,” retransmission consent “contract term disclosure,” and “out-of-market network affiliate negotiations,” among other mechanisms considered to be potential useful tools in achieving an arguably more equitable level of payments. However, if the decision is made to pursue these latter avenues, it is likely that the regulatory and legislative climate in Washington soon will be more conducive to these reforms.

With the prospect of a more Democratic Congress, a change in the party of the presidency and, if the latter, a change in the party of the FCC Chairman, enhanced forms of regulation well may attach to the retransmission consent concept. As noted herein, democratic commissioners have expressed their views that a regulatory “fix” might be needed to ensure more fair and expeditious negotiation of retransmission consent fees.

Such sentiment can be expected to a controlling factor in future FCC decision making in these areas if a Democrat were chairing the FCC under a democratic president.

Another potential external “fix” to the retransmission consent problems observed by NTCA deals with the efforts – thus far unsuccessful – of over-the-air broadcasters to obtain “must carry” of the entirety of their stations’ digital broadcast bitstream.

Although digital terrestrial television broadcasters may transmit up to four or five channels of programming over the same 6 MHz bandwidth that traditionally has been used by analog broadcasters to offer only one channel of programming, the FCC only has mandated<sup>111</sup> that a station’s “primary video” – one channel of programming selected by the broadcaster – is deserving of “must carry status. Such a regulatory approach has been cheered by cable operators (to the extent that operators accept the notion of “must carry” at all) and reviled by broadcasters finding it incomprehensible that a station’s digital program streams – all subject to various FCC content regulations – would not reach the audience they are licensed to serve where that audience subscribes to a local cable system or other MVPD.

The long term success of over-the-air broadcasters depends on their ability to reach viewers who do not receive their signals over-the-air but via a MVPD.

Broadcasters understand this reality and are likely to take whatever steps are necessary to reach the entire local audience with all the program offerings contained in their digital bitstreams. One route that might well be considered is the one advocated by Massillon Cable TV. The Massillon plan is described in the “Save Our Set Coalition” website.<sup>112</sup>

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<sup>111</sup> *First Report and Order and Further Notice of Proposed Rule Making* in CS Docket No. 98-120, 16 FCC Rcd. 2598 (2001), affirmed *Second Report and Order and First Order on Reconsideration* in CS Docket No. 98-120, released February 23, 2005.

<sup>112</sup> [www.saveoursets.com](http://www.saveoursets.com)

The essence of this plan is that stations forfeiting their right to retransmission consent fees would have their signal (including multicast channels) delivered to all homes passed by cable systems in their service areas. Such a trade-off is one of several possible options that broadcasters might choose to take in order to achieve cable carriage of all the programming offered within their digital bitstreams. Other permutations of this concept might involve reduced retransmission consent fees in exchange for some level of “greater-than-primary signal” carriage. Other approaches could be based on the imposition of some form of retransmission consent fee cap in exchange for a guaranteed level of broadcasters’ multicast offerings distributed over cable.

## Mandatory Arbitration

**Introduction:** Prior to the passage of the Cable Television Consumer Protection and Competition Act of 1992,<sup>113</sup> cable companies had been allowed to include locally broadcast television signals on their cable systems without first obtaining permission from local broadcasters. The rationale was that these signals were already available to local households, over-the-air, for free. The Cable Act, in combination with *network non-duplication* and *syndicated exclusivity* rules,<sup>114</sup> changed this practice by creating a *legal monopoly*<sup>115</sup> for network television stations in each market when it forbid cable companies from carrying the signals of local stations without the express authority of those stations.<sup>116</sup> History shows this shift in public policy would significantly change the regulatory landscape and eventually create an environment of disproportionate bargaining power.

Since 1992, local commercial television stations must, on a system-by-system basis, elect between “must carry” and “retransmission consent.” This process occurs every three years. If the station elects “retransmission consent,” it gives up the right to mandatory carriage (must carry), but must negotiate in “good faith” with multichannel video programming distributors (MVPD)<sup>117</sup> to compensate the broadcaster for carriage of the broadcast signals.

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<sup>113</sup> Pub. L. No. 102-385, 106 Stat. 1460

<sup>114</sup> 47 C.F.R. 76.92 and 47 C.F.R. 76.103

<sup>115</sup> A monopoly is defined as a persistent market situation where there is only one provider of a service (network programming), in other words a firm that has no competitors in its industry. Monopolies are characterized by a lack of economic competition for the service that they provide and a lack of viable substitute service.

<sup>116</sup> 47 U.S.C. § 325(b)(1)

<sup>117</sup> MVPD is a term defined by the Federal Communications Commission to mean a cable operator, a multiple channel distribution service, a Direct Broadcast Satellite service, or a television receive only

Section 325(b)(3)(C) of the Communications Act obligates broadcasters and MVPDs to negotiate retransmission consent agreements in good faith.<sup>118</sup> Specifically, Section 325(b)(3)(C)(ii) directs the Commission to establish regulations that:

. . . until January 1, 2010, prohibit a television broadcast station that provides retransmission consent from engaging in exclusive contracts for carriage or failing to negotiate in good faith, and it shall not be a failure to negotiate in good faith if the television broadcast station enters into retransmission consent agreements containing different terms and conditions, including price terms, with different multichannel video programming distributors if such different terms and conditions are based on competitive marketplace considerations.<sup>119</sup>

While contractual business agreements often contain language identifying the method in which disputes will be resolved, and are intended to push parties toward agreement before a breakdown in negotiations, this is not the case for retransmission consent. There is no prescribed statutory requirement for arbitration in those circumstances where negotiations in “good faith” for retransmission consent fail to lead to mutual agreement. Further, in two recent cases, Suddenlink and Mediacom, the FCC has expressed a reluctance to formally get involved in retransmission consent negotiation disputes.<sup>120</sup> This creates an environment, similar to Las Vegas where the odds are always with the house, and in which negotiations are conducted on less than a level playing field.

**Regulatory Imbalance:** Retransmission consent rules promulgated by the FCC require negotiations in “good faith . . . based on competitive marketplace considerations,”

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satellite program distributor who makes available for purchase by subscribers or customers multiple channels of video programming.

<sup>118</sup> 47 U.S.C. 325(b)(3)(C)

<sup>119</sup> 47 U.S.C. 325(b)(3)(C)(ii)

<sup>120</sup> See *Cebridge Acquisition, LLC d/b/a Suddenlink Communications v. Sinclair Broadcast Group* (CSR-7038-C), Order, released August, 14, 2006, and *Mediacom Communications Group, Inc. v. Sinclair Broadcast Group* (CSR-7058-C), Memorandum Opinion and Order, released January 4, 2007.

the reality is that those negotiations rarely occur on a level playing field. One example of this imbalance would be allowing broadcasters to use nondisclosure agreements (NDA's) to hide critical, competitive marketplace pricing data from MVPD entities during retransmission consent negotiations. This creates disproportionate bargaining power via *asymmetric information*.<sup>121</sup> In *Mediacom Communications Corp. v. Sinclair Broadcast Group*,<sup>122</sup> the FCC held that (1) there was no obligation for the broadcaster (Sinclair) to agree to marketplace rates, and (2) the broadcaster did not have to disclose the terms and prices of agreements with other systems to establish the "marketplace" price for its signal. The Commission held that if the broadcaster was incorrectly valuing the television signal, then it (Sinclair) would suffer in the "marketplace" if the station was not carried. Unfortunately, the exact opposite was true for Mediacom, where the battle with Sinclair cost the cable operator approximately 7,000 basic subscribers.<sup>123</sup>

Other factors affect the ability to negotiate in an open, free marketplace. For example, *network non-duplication* and *syndicated exclusivity* rules<sup>124</sup> mentioned earlier eliminate the opportunity for MVPD firms to negotiate with multiple, out-of-market (DMA) television stations offering similar programming for the "best" price. Thus, "good faith" negotiations do not always equate to "fair" negotiations when the playing field is skewed as a matter of public policy.

The National Cable and Telecommunications Association (NCTA) has always taken a neutral stand on retransmission consent because it had members on both sides of

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<sup>121</sup> Asymmetric Information is a term used to describe an environment in public policy where critical information is missing or controlled by a firm that has an incentive to withhold or misrepresent it.

<sup>122</sup> *Mediacom Communications Group, Inc. v. Sinclair Broadcast Group (CSR-7058-C)*, Memorandum Opinion and Order, released January 4, 2007.

<sup>123</sup> Mike Farrell, "Sinclair Fight Cost Mediacom Subs," [Multichannel News](#), February 23, 2007.

<sup>124</sup> 47 C.F.R. 76.92 and 47 C.F.R. 76.103

the issue. That stand changed recently when Kyle McSillarow, president and CEO at NCTA, said that retransmission consent was often mischaracterized as a “free-market issue.”<sup>125</sup> In a recent interview with TVNEWSDAY, McSillarow commented on the fairness of the current regulatory environment:

“You start first with spectrum and a platform that was provided for free for broadcasters. Then you say, the content is provided on an exclusive basis, with network nonduplication and syndex rules,” he said. “Then the law says, there’s a choice between simply asking for carriage or retransmission consent. It’s a heads I win, tails you lose, regime. When they walk into a negotiation... their carriage is by law guaranteed on the basic tier, and consumers have to buy the basic tier before they buy any other tier. So when it’s referred to as a free market negotiation, they’re forgetting about this regulatory regime that’s already in place.”<sup>126</sup>

**Retransmission Landscape:** Following the enactment of the Cable Consumer Protection and Competition Act of 1992 and the generation of retransmission consent regulations by the FCC,<sup>127</sup> large market broadcasters tended to opt for retransmission consent, negotiating for some combination of cash payment, carriage of a separate channel (e.g., news/weather), channel placement, or promotional consideration (advertising). Broadcasters in smaller markets tended to elect must carry.

In 1992, over 80 percent of commercial broadcast television stations and 90 percent of network affiliates opted to negotiate retransmission consent agreements.<sup>128</sup> By 1996, it was estimated that eight out of every ten commercial television stations still

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<sup>125</sup> “Retransmission Consent Reform: Not So Fast,” TVNEWSDAY, June 12, 2007.

<sup>126</sup> “Cable Chief Is Not Taking it Personally,” TVTechnology.com, March 16, 2007.

<sup>127</sup> 47 C.F.R. 76.64 (1994).

<sup>128</sup> In the Matter of Carriage of the Transmissions of Digital Television Broadcast Stations, Notice of Proposed Rulemaking, CS Docket 98-120, FCC 98-153 (released July 10, 1998).

opted to pursue retransmission consent agreements.<sup>129</sup> Today, in an era of reduced network compensation to affiliates, and given the financial choice between “must carry” and “retransmission consent,” the understandable trend is for local television broadcasters to readily elect the latter, regardless of market size.

The financial value of these retransmission consent agreements to a broadcast station is captured by economist Mark Fratrick, VP of BIA Financial Network, who recently stated, “Retransmission consent goes right to the bottom line. So even if it's 3 to 5 percent of revenue, it's 10 to 15 percent of cash flow.”<sup>130</sup> While broadcasters rarely break out cash compensation from retransmission-consent deals, the financial impact to individual stations and group owners can be significant. Hearst-Argyle Television indicated it collected \$17.9 million in retransmission consent revenue in 2006, up from \$6.8 million in 2005, a 163% increase. Hearst-Argyle expects to receive from \$18 million to \$20 million in 2007.<sup>131</sup>

Another publicly traded company, Sinclair Broadcast Group, Inc. (NASDAQ: SBGI), expects 2007 retransmission consent revenues to exceed \$60 million. David Smith, President and CEO of Sinclair, said:

We now estimate that our 2007 revenues from our retransmission consent agreements will be approximately \$60.5 million, as compared to \$25.4 million last year, a 138% increase. For 2008, we expect this number to grow to approximately \$66.0 million based on what we have under contract today. This estimate does not include the remaining 10% of the subscribers in our markets for which we do not yet have longer-term contracts in place and excludes revenues from our retransmission consent agreements for WGGB-TV, the sale

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<sup>129</sup> James M. Burger, Esq. and Todd Gray, Esq. The Effect of DTV on Business Negotiations, Digital Television and the Law, April 1999, reported in Stuart N. Brotman, “Priming the Pump”: The Role of Retransmission Consent in the Transition to Digital Television, October 1999. See [http://www.brotman.com/whatsnew\\_article\\_priming\\_III.html](http://www.brotman.com/whatsnew_article_priming_III.html).

<sup>130</sup> Katy Bachman, Forecast 2007: TV Stations, January 1, 2007. See [http://www.mediaweek.com/mw/current/article\\_display.jsp?vnu\\_content\\_id=1003526169](http://www.mediaweek.com/mw/current/article_display.jsp?vnu_content_id=1003526169).

<sup>131</sup> “Hearst-Argyle Cash From Retrans Rises,” Multichannel News, February 26, 2007.

of which we expect to close in the fourth quarter 2007.<sup>132</sup>

These recent, large shifts in retransmission consent income by broadcasters come as the result of a number of converging conditions. First is the inability of public policy to keep pace with changing structural conditions in the marketplace. Rules that were originally designed to protect broadcasters from a local cable system who could use countervailing power to reject demands for cash payments, no longer apply. When coupled with existing regulations, namely network non-duplication, syndicated exclusivity, must carry and retransmissions consent, regulators have allowed the emergence of a skewed, monopoly market environment where open, fair negotiation of the “price” of content is impossible. In a world where content is king, there is no substitutability for program fare when an individual station, not the marketplace, is allowed to independently control the price, terms and conditions for local access to unique programming of national interest. RESULT: A sustained legal monopoly where a skewed playing field allows negotiations over price, terms and conditions to be controlled by one party at the expense of the other, resulting in excessive, higher programming costs passed along to consumers.

Second, advances in technology have led to a new competitive landscape. Today, the MVPD competitive environment often includes cable, multiple direct broadcast satellite (DBS) providers, and increasingly telephone firms. RESULT: Lacking competitive, market-based information on “price,” local MVPD entities who reach a negotiating impasse over retransmission consent that involve unwarranted,

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<sup>132</sup> Source: Sinclair Broadcast Group, August 1, 2007. See also, “Sinclair Reports Second Quarter 2007 Results,” <http://www.prnewswire.com/cgi-bin/stories.pl?ACCT=104&STORY=/www/story/08-01-2007/0004636793&EDATE=>

excessive demands for cash and other compensation with a local broadcaster will lose subscribers to a competing MVPD service or the national DBS providers.

Third, small, independent, rural MVPD entities are particularly vulnerable to the current policy environment. Large, national cable MSO's (i.e., Comcast, Cox, Time Warner, etc.), Tier 1 telephone firms (i.e., AT&T, Verizon, etc.), and the DBS satellite providers (DirecTV, Dish Network, etc.) appear to have sufficient market power to reject exorbitant demands and successfully negotiate reasonable retransmission consent agreements. RESULT: Absent market forces, small, independent cable firms and independent telephone firms in rural markets are vulnerable to disproportionate bargaining power and highly susceptible to unwarranted demands for cash and other compensation during retransmission negotiations.

**Mandatory Arbitration:** If the marketplace has changed since 1992, with technology and legacy regulations creating an imbalance in the policy arena, then the proper course for the FCC and Congress is to correct this imbalance and level the playing field. For disputes over retransmission consent, one option is to require mandatory arbitration where negotiations fail to result in a mutually agreeable solution.

The current Commission's view on arbitration is mixed. In approving the 2004 News Corporation (News Corp.) acquisition of DirecTV,<sup>133</sup> the FCC allowed the creation of the first vertically integrated DBS provider. As a result, News Corp. controls the second largest MVPD and also a vast array of other programming under its Fox Corp. subsidiary. The FCC recognized there would be competitive concerns arising from this

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<sup>133</sup> General Motors Corp., and Hughes Electronic Corp., Transferors, and News Corp. Ltd., Transferee, Memorandum Opinion and Order, 19 FCC Rcd. 473 (2004).

integration and conditioned the transaction on allowing cable operators to seek “private arbitration” in the event they believed News Corp. was being unfair in contract negotiations over the rights to carry a Fox TV station, or a regional sports network (RSN). Further, News Corp. promised it would not discriminate against cable providers, charging them the same price it charged DirecTV. News Corp. also promised to increase the number of markets where DirecTV offers local broadcast channels as a formal condition of the merger, which unintentionally ends up adding pressure to local MVPD to accept unwarranted price, terms and conditions during retransmission consent negotiations, or risk losing subscribers to national DBS providers.

The Commission justified the imposition of commercial arbitration as follows:

We find that a neutral dispute resolution forum would provide a useful backstop to prevent News Corp. from exercising its increased market power to force rival MVPDs to either accept inordinate affiliate fee increases for access to RSN programming and/or other unwanted programming concessions or potentially to cede critical content to their most powerful DBS competitor, DirecTV. We therefore create a mechanism whereby an aggrieved MVPD may choose to submit a dispute with News Corp. over the terms and conditions of carriage of RSNs to commercial arbitration to constrain News Corp.’s increased incentive to use temporary foreclosure strategies during carriage negotiations for RSN programming in each region in which News Corp. owns or holds a controlling interest or manages any non-broadcast RSN.<sup>134</sup>

In 2007, the FCC approved the sale of bankrupt cable provider Adelphia Communications to Comcast and Time Warner Cable. Similar to the News Corp. deal, the FCC required the two cable companies to enter into binding arbitration if they can't reach a deal with competitors on local sports programming.<sup>135</sup>

In these two instances, the Commission believed the mere existence of an arbitration condition would push parties toward agreement prior to a complete breakdown

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<sup>134</sup> Subject to Conditions, Commission Approves Transaction Between General Motors Corporation, Hughes Electronics Corporation and the News Corporation, Public Notice (FCC 03-328), released December 19, 2003.

<sup>135</sup> Ted Hearn and Mike Farrell, “FCC Approves Adelphia Merger,” Multichannel News (July 13, 2006).

in negotiations. Specific to News Corp., the Commission believed mandatory arbitration reduces the incentives and opportunities for News Corp. to withhold programming as a bargaining tool. Unfortunately, the Commission has not thought to extend this condition to address marketplace issues beyond mergers and acquisitions (M&A).

Since 2004, the Commission has repeatedly refused to invoke arbitration as a remedy in similar circumstances involving retransmission consent disputes between cable systems and television stations. The Commission’s policy of recommending “voluntary” arbitration where (1) disproportionate market power, and (2) the potential abuse of withholding programming as a bargaining tool are issues, has failed to bear fruit.<sup>136</sup>

The recent cases in *Suddenlink Communications*<sup>137</sup> and *Mediacom Communications*<sup>138</sup> are also a testimony of the Commission’s reliance on the “stonewalling” provisions of the *Reciprocal Bargaining Order*:

MVPDs and broadcasters alike will not be required to engage in an unending procession of extended negotiations . . . [P]rovided that a party to a [good faith] negotiation complies with the requirements of the Commission’s rules, failure to reach agreement would not violate either Section 325(b)(3)(C) or Section 76.65 of the Commission’s rules.<sup>139</sup>

Absent any threat of penalty for protracted negotiations, a predetermined strategy of “failure to reach agreement” becomes a strategic part of the bargaining process to force MVPD acceptance of unwarranted price, terms or conditions during retransmission consent discussions.

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<sup>136</sup> Linda Moss & David Cohen, “Iowa, Missouri Eye Mediacom-Sinclair Actions,” *Multichannel News* (January 12, 2007)

<sup>137</sup> See *Cebridge Acquisition, LLC d/b/a Suddenlink Communications v. Sinclair Broadcast Group (CSR-7038-C)*, Order, released August, 14, 2006.

<sup>138</sup> *Mediacom Communications Group, Inc. v. Sinclair Broadcast Group (CSR-7058-C)*, Memorandum Opinion and Order, released January 4, 2007.

<sup>139</sup> *Reciprocal Bargaining Order*, 20 FCC Red at 10339.

**Strategic Options** : There are a number of changes in the public policy arena that would improve the retransmission consent landscape. Some options referenced in this section, for example (1) use of non-disclosure agreements (NDAs), and (2) opening the option for out-of-market content (DMA) negotiations, are addressed elsewhere in this paper. The focus of the balance of this section will be to examine the potential of mandating arbitration as a balanced solution for addressing those circumstances where fair, “good faith” negotiations over prices, terms and conditions reach an impasse.

There are two viable options for change available to MVPD players in the public policy arena, (1) regulatory change, and (2) statutory change. These options are not mutually exclusive.

First, the FCC’s current position of promoting “voluntary arbitration” is non-workable, especially for MVPDs in smaller markets. Regulatory relief can occur if the FCC were to pass new rules which prescribe mandatory arbitration, or at a minimum adopt a more pro-marketplace philosophy in interpreting the “good faith” negotiation provisions of the Act.<sup>140</sup> While the current Commission under Chairman Kevin Martin has refused to provide relief on past complaints for failure to negotiate retransmission consent rights in good faith, nor has it exhibited any inclination to modify policy in response to industry proposals and suggestions requested annually by the FCC,<sup>141</sup> there is some indication that a potential for regulatory change exists.

Not all Commissions are of like mind as to how well retransmission consent has worked since 1992. In spite of the FCC’s official position resisting direct intervention,

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<sup>140</sup> 47 U.S.C. 325(b)(3)(C)

<sup>141</sup> In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, Notice of Inquiry, MB Docket No. 06-189 (released Oct. 20, 2006).

settlement in the *Mediacom* case was facilitated by the unofficial, active participation and mediation efforts of two FCC Commissioners, McDowell and Adelstein.

McDowell and Democratic FCC Commissioner Jonathan Adelstein had met privately with the executives to try to resolve the issue, and said that a deal did get hammered out on the eve of the Super Bowl. . . . Most of the commissioners said the powers to insert themselves into carriage negotiations were limited, though Commissioner Adelstein suggested that Congress might have unintentionally given companies [broadcasters] a trump card over the interests of consumers by not giving them [FCC] more explicit authority.<sup>142</sup>

The current Republican majority on the Commission has indicated it has no interest in involving itself in the retransmission consent controversy.<sup>143</sup> However, Democratic Commissioners Adelstein and Copps saw the role of the FCC differently during a recent House Telecommunications Subcommittee oversight hearing.

FCC Commissioner Jonathan Adelstein suggested today that the FCC should jump into retransmission consent disputes between broadcasters and cable operators if the interest of the viewing public is threatened, and fellow Democrat Michael Copps called for an "overall look" into whether retrans is working as intended. . . . The FCC should protect the viewing public by mandating binding arbitration or interim carriage "if no consensus is reached between the parties," Adelstein said.<sup>144</sup>

With a potential for a change in administration at the White House next year, the prospect of new leadership and a more market-oriented Commission in the area of retransmission consent could be only months away.

Second, the prospect of amending the Communications Act to provide the Commission with explicit authority to impose binding arbitration, as suggested by Commissioner Adelstein, is not out of the question. Oversight hearings in both the

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<sup>142</sup> John Eggerton, "McDowell and Adelstein Weigh In On Retrans Talk," *Broadcasting and Cable* (March 14, 2007). See [www.broadcastingcable.com/article/CA6424526.html](http://www.broadcastingcable.com/article/CA6424526.html).

<sup>143</sup> Ted Hearn, "Martin to Other FCC Members: No Arbitration," *Multichannel News* (February 2, 2007).

<sup>144</sup> Harry A. Jessell, "Adelstein, Copps See Retrans Roles for FCC," *tvnewsday* (March 14, 2007).

Senate Commerce Committee and the House Subcommittee on Telecommunications and the Internet, provide evidence that a few members of Congress, on both sides of the aisle, are less than satisfied with Chairman Martin's leadership on issues including retransmission consent, are unhappy with the FCC's decisions under his watch.

On the Senate side, Senator Boxer (D-Calif.), Senator Rockefeller (D-WV), Senator Dorgan (D-ND), Senator Kerry (D-Mass.), Senator Sununu (R-NH), and Senator Snowe (R-Maine) have all suggested there are problems with FCC Chairman Martin's stewardship. Indeed, some of highest ranking members of the Commerce Committee, including the chairman, Senator Inouye (D-Hawaii) and the vice chairman, Senator Ted Stevens (R-Alaska), were specifically critical of the FCC's handling of the Mediacom retransmission consent dispute, and believe the FCC already has the power to force the parties into binding arbitration without a finding of bad faith.<sup>145</sup> These concerns are not new. In a 2005 keynote address, Senator Stevens said,

"There is no question that there ought to be a level playing field. We didn't bring about the retransmission concept in order to give a group more power over those who they deal with in the process of carrying out must-carry."<sup>146</sup>

On the House side, Representative Deal (R-GA) has been a consistent critic of the retransmission process. Last year, he sponsored an amendment that would have (1) established a shot clock on negotiations, then send them to arbitration, (2) allowed for pool bargaining, and (3) required broadcasters to supply the FCC with pricing information.<sup>147</sup> In oversight hearings with the FCC in February 2007, he reacted to the

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<sup>145</sup> Brooks Boliek, "In Control, Democrats Host FCC's Martin," Hollywood Reporter, February 1, 2007.

<sup>146</sup> Summit 2005, ACAAction Newsletter, May 27, 2005. Available at: <https://www.americancable.org/news/acaction/acanewsletter052705.pdf>

<sup>147</sup> <http://www.broadcastingcable.com/index.asp?layout=articlePrint&articleID=CA6327020>

announced settlement of the *Mediacom* retransmission controversy, and questioned the effectiveness of FCC policy and reliance on marketplace forces.

Deal said he did not accept that an agreement meant the process was working or that the system was fair or all parties are willing participants. Deal complained in his opening statement that the process was broken, that stand-offs like the one between Sinclair and Mediacom were just the tip of the iceberg, and the process "lacks the principles we find in a free market."<sup>148</sup>

John Dingell (D-Mich.), chairman of the House Commerce Committee, and Ed Markey (D-Mass.), chairman of the House Subcommittee on Telecommunications and the Internet, have also been critical of the FCC and Martin's stewardship.<sup>149</sup> At the same time, both have been supportive of broadcasters and the concept of retransmission consent. Chairman Dingell told a NAB-sponsored leadership conference in February 2007 that he believed broadcasters had a right to negotiate carriage in an open marketplace, but broadcasters needed to keep the "best interests" of consumers in mind. According to Colin Crowell, a senior staffer on the House Energy and Commerce Committee, the topic of retransmission consent is timely and will likely make the agenda of a "Future of Video" oversight hearing in the House Subcommittee, however it was not part of the hearing on May 10th.<sup>150</sup>

Chances to develop a successful campaign to have Congress revisit retransmission consent and amend the Cable Act of 1992 are probably better this term than in past. Yet a high "possibility" of reform does not necessarily equate to a high "probability" of reform. As one trade magazine, *Multichannel News*, speculated:

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<sup>148</sup> John Eggerton, "McDowell and Adelstein Weigh in on Retrans Talk, Broadcasting & Cable (March 14, 2007). <http://www.broadcastingcable.com/article/CA6424526.html>

<sup>149</sup> Brooks Boliek, "In Control, Democrats Host FCC's Martin," *Hollywood Reporter*, February 1, 2007.

<sup>150</sup> John Eggerton Broadcasters Get Retrans Support from Markey, Dingell, *Broadcasting & Cable* (February 27, 2007).

When Congress allowed broadcasters to demand cash from cable operators for station carriage, lawmakers expected more investment in broadcast. Instead, ABC, CBS, NBC and Fox invested in cable, dominating expanded basic. Once Congress realizes programmers are forcing distributors to buy unwanted fare, it will instate universal must-carry.<sup>151</sup>

This quote may be wishful thinking, but it does suggest that Congress must be brought up-to-speed on the real issues involved in retransmission consent, the economic and social costs of blindly accepting the status quo, and come to understand that the “costs and benefits” of policy crafted in 1992 are not evenly distributed across all markets in 2007. Change requires an understanding that new players compete in a changed environment, and old rules impact consumers differently today. Even here, logic and reason may not rule the day, so industry-based (MVPD) coalitions and a unified strategy are paramount.

In the m-dimensional arena of public policy, multiple players, the determiners of regulatory policy, will compete to move the ball (agenda) toward their desired position. A successful pre-game strategy is to have more people agreeing to push the ball toward your goal than against it. If most of the players (Regulators, Congress, Industry, and Courts) are in agreement with you as to where the final locations of the ball should rest, it is a WIN-WIN campaign.

In this national pre-election period, it's good to fill in the roster of team players and develop a winning game plan that involves as many determiners as possible who can agree on the major goal, including the primary opponent if possible. In the end, presenting a single solution from a united front removes Congress from taking sides and they happily become part of, and will take credit for, any successful solution.

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<sup>151</sup> Staff, “From Franchise Reform to Retrans, Handicapping Some of Cable’s Top Issues in the Coming Year,” Multichannel News (January 1, 2007).

## **ACTION ALTERNATIVE: OUT OF DMA NEGOTIATION**

This section examines the arguments for and against allowing cable systems to negotiate with television stations outside their Designated Market Areas (DMA).

Under the current regulatory system, a television station may order cable systems within the DMA to carry it (must carry), in which case the station receives no compensation. Alternatively, the local television station may choose to negotiate for retransmission consent, demanding some form of compensation for providing the channel to the cable system. As previously noted, in the 1990s this primarily took the form of request for carriage of a second signal but of late has been the demand for cash payment. Cable systems essentially have a “take it or leave it” choice.<sup>152</sup> Their alternative is to accept the broadcasters’ conditions for retransmission or not include the signal in its channel offerings. Television stations are emboldened in the knowledge that satellite providers make their channels available, so a rejection by cable companies is an incentive for subscribers to switch from cable to satellite service. As Charles Goldfarb, specialist in Industrial Organization and Telecommunications Policy for the Congressional Research Service stated,

Programmers have more options available to them to reach audiences and are able to negotiate with distributors from a position of strength, often demanding terms, conditions and rates that are favorable to themselves and less favorable to distributors than those that have prevailed in the past.<sup>153</sup>

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<sup>152</sup> This expression has been used repeatedly in filings and announcements by the American Cable Association, but has been picked up by media reporting on the retransmission battles. *See*. “Mediacom Expresses Shock at the Unmitigated Arrogance and Misrepresentations Contained in Sinclair’s Letter to Senators Inouye and Stevens,” *Business Wire*, Feb. 1, 2007; J. Higgins, “Cable, Broadcast Battles End,” *Broadcasting & cable*, Feb. 6, 2006; K. Neel, “Retrans Consent Deals Get Tougher Every Day,” *Cable World*, Feb. 10, 2003.

<sup>153</sup> Charles Goldfarb, “Retransmission Consent and Other Federal Rules Affecting Programmer-Distributor Negotiations: Issues for Congress,” CRS Report RL34079, July 9, 2007, p. 11. Hereinafter cited as RL34079.

It is fallacious to call this retransmission consent process “negotiation.” Cable companies are unable to negotiate. Their only option is to accede to the broadcaster’s requests or go without the channel. The brouhaha in those instances where cable systems have dropped (or nearly dropped) local broadcast stations has been loud and contentious.<sup>154</sup> Cable companies make the claim that broadcasters’ demands will cause subscribers to have to pay more while broadcasters claim that the cable companies are charging subscribers for their channels and expect not to have to share some of that revenue with the broadcasters providing the content.

What seems to be ignored in these debates is the content itself. Most MVPDs are interested in providing the content to their subscribers and would be happy providing that content from any source, but they are forced to negotiate with one and only one provider for the content they want most: the network-provided programs and nationally syndicated programs. The majority of what local television stations provide is not locally-produced content.

If we examine the sort of content a local broadcast television station provides, it breaks down approximately this way:

Content provided by the network:	60 percent <sup>155</sup>
Content provided by national syndicators:	25 percent
Locally-produced content:	15 percent

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<sup>154</sup> It has been so contentious that in at least one instance, a city has threatened a cable provider with a lawsuit for dropping a broadcast signal. Bossier City, Louisiana threatened the Cox cable system with legal action for violation of the franchise agreement for dropping the NBC-affiliated station. Cox claimed the station was dropped due to the inability to reach a retransmission consent agreement with station owner Nexstar. “Cox Maneuver Puts TV Stations Back on Cable,” *Communications Daily*, Feb. 3, 2005.

<sup>155</sup> ABC, CBS and NBC provide approximately this amount. It would be less for Fox. For those stations, syndicated and network-provided percentages are reversed, but locally produced remains the same.

When a local cable operator wants to provide *The Late Show with David Letterman*, there are nearly 200 different television stations that carry the program, at least two or three of which would be reasonably easy to receive and provide to subscribers. The program content is the same whether the program is being broadcast by a station in New York or Los Angeles. Because of the current statutes, cable systems are proscribed from obtaining the program from anyone but their local CBS affiliate. Similarly, when a local cable operator wants to provide *Oprah* to local subscribers, one and only one television station must be the source of the program, despite the fact that other stations distribute *Oprah*.

The majority of local programming produced by stations is news. Here, finally, is an example of content where local stations are actually in competition in a manner that assists the cable operator in negotiation. While news executives would assert that viewers choose their stations for the quality of their news, there is plenty of evidence that local audiences find local newscasts somewhat interchangeable.<sup>156</sup>

Thus if we think of MVPDs as negotiating for *programs*, approximately 85 percent of the content they try to acquire from local network affiliates (the network and nationally syndicated programs) are available from one and only one source. The local station that has the contract to provide a particular program is the monopoly provider of that content. There is nothing *natural* about this monopoly for it exists because of legacy policy from a time when economic and technological conditions were quite different.

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<sup>156</sup> For example, *Oprah* is known nationwide as a strong lead-in for local news, and the program occupies that position in most markets. In those markets where *Oprah* has changed stations, the newscast immediately following shows an instant, dramatic increase in viewers. It's not that the quality of the newscast has improved but that viewers don't discern any difference in the newscasts and simply leave the channel where it was.

## A Legislative Solution

As Goldfarb points out, “There is precedence for changing regulations affecting the programmer-distributor relationship as market conditions change.”<sup>157</sup> In the above hypothetical, if a cable system is unable to negotiate a retransmission consent agreement that it considers to be fair with the local CBS affiliate, the cable system will be prohibited from carrying the station for three years. Fans of *The Late Show* will be likely to drop their subscriptions to the cable system in favor of another provider that has the program (for example a satellite TV service).<sup>158</sup> If the MVPD instead were allowed to negotiate with other CBS affiliates outside the DMA, it might conceivably be able to find a station that would provide the content at a rate it considered reasonable. More likely the mere competitiveness of “bidders” seeking to attract other cable system viewers would create *true* marketplace competition, resulting in a lower cost. It is self-evident that if all other things were equal a cable system would prefer to receive *The Late Show* from its local station rather than some more distant one. If the cost difference is significant, however, the MVPD should be given the option to shop for the programs in an open marketplace.

By allowing cable operators to carry television network affiliates outside the DMA, competition would enter into the equation and prices would be more market driven. Rates paid by cable systems (and passed on to their subscribers) would be more pegged to their real value rather than an artificially inflated value that results from a government-protected monopoly.

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<sup>157</sup> RL34079, *supra* note 114, at note 23.

<sup>158</sup> Television station owner Sinclair has boldly stated that increased competition between cable, satellite and telephone services for carriage of its programming has increased Sinclair’s negotiating power. *See* RL34079, *supra* note 114, at 11.

What would be the logical outcome of legislation that would allow such negotiation? Here are the likely scenarios:

**Scenario A: Large Cable System in the Heart of a Large Market**

Because cable systems provide the video programming for approximately 60 percent of American homes, a major cable provider in the largest cities is of critical importance to local stations. Television stations in these markets *need* these viewers and would be harmed financially if the cable systems were to contract with an out-of-DMA provider of network content. If network programming were all that a local station provided, cable systems in these markets would be able to negotiate from a relatively powerful position.

The reality, however, is that these viewers are the ones most interested in the local newscasts. Viewers at the heart of the market are the ones whose governments, school systems and traffic are most attended to by the stations. If cable systems at the heart of major markets were to opt for out-of-DMA stations over the local ones, these viewers would be the ones most likely to grouse about the loss of local news coverage. A natural tension exists between the power of the cable company to provide local viewers to a major market station and the power of local news by the station. One forecaster predicts that large markets might actually see *more* retransmission consent stalemates if all MVPDs in large markets have the ability to negotiate with network affiliates outside of their markets.<sup>159</sup>

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<sup>159</sup> RL34079, *supra* note 114, at 61.

**Scenario B: Small Cable Systems at the Periphery of a Large Market**

Unlike the previous example, viewers on the outskirts of a market actually have less value to a metropolitan station than more centrally-located viewers. This is because the Nielsen ratings for a market are broken into metro ratings and DMA ratings. A national advertiser (like Coca-Cola) wants to reach everyone in a DMA because they are all potential consumers, but local businesses may not have that kind of reach. A dry cleaner who has multiple locations in a city may want to buy TV advertising to reach customers near their locations, but viewers 40 miles from downtown are less likely to use their services.

This is not to suggest that the outlying viewers are unimportant, but it is clear that they are *less* valuable to the television station than other viewers. This reduces the position of power that the cable companies enjoyed in Scenario A. In this scenario, local news is less important to the viewers as well. Again, it is not that the news has no value but it certainly has less value. In some instances where viewers find themselves at the periphery of a market some may actually be more interested in news from a neighboring market (perhaps they commute there rather than the center of their own market). As a result, the cable system is less powerful because its viewers are less valuable to stations, and stations' positions are less powerful because less of their exclusive product (local content) matters to viewers farther away.

**Scenario C: Small Markets**

The situation in small markets is far more delicate than in large markets. The amount of money involved is significantly less, but as such each dollar is a larger

percentage of revenues. Both small market stations and small market MVPDs must be careful to maximize revenue and minimize expenses wherever possible. This is a major contributor to the recent increased retransmission consent revenues for stations: the realization by these stations that a new lucrative revenue stream can be created at no expense. This is also the reason the scenario is so advantageous to the station: as a monopoly provider of content, the cable system in the small market has no choice but to agree to its demands.

Creating the option for negotiation out-of-DMA in small markets is likely to have the greatest impact on the current dynamic. Small markets located not very far from large markets may contain viewers who have a greater interest in a nearby large market than their very own small market. For example, Youngstown, Ohio is ranked 103<sup>rd</sup> in market size, but it is located a mere 73 miles from Cleveland, which is ranked 17<sup>th</sup>. Currently cable systems in the Youngstown DMA must negotiate retransmission consent with Youngstown television network affiliates. If the option existed for the systems to negotiate with Cleveland stations as well as Youngstown stations, the Youngstown stations might feel threatened. Certainly Youngstown residents benefit more from local Youngstown news but they may be more interested in shopping, commerce and the professional sports franchises located in Cleveland.

Smaller markets are also most likely to have lower population densities, which in turn makes provision of multichannel services by wire less cost efficient. Cable providers are more affected by population density than satellite providers. This economic disadvantage combined with the government-created monopoly that prevents the cable system from obtaining the programming from any other content provider creates a

playing field that is anything but level. Were it not for government regulation prohibiting out-of-DMA negotiation, cable systems in small communities would be able to use the power of the marketplace to negotiate better prices. Cable systems in the Youngstown market would be able to obtain *The Late Show* from Cleveland if the Youngstown station demanded too much for carriage.

It is not by coincidence that most of the interruptions of service of broadcast television by cable systems have occurred in small markets. There is almost a direct inverse proportion between market size and likelihood of interruption. The battles between Nexstar Broadcasting and Cox Communications involved one station in the top 100 markets: Shreveport, Louisiana (market size 81 – far from what one would consider a “large” market). The others were all in small markets: stations in Joplin, Missouri (market size 144), Abilene, Texas (market size 164) and San Angelo, Texas (market size 197).<sup>160</sup> The “eleventh hour” agreement between Mediacom and Sinclair involved a mix of two small market, seven medium market and seven large market stations in Minneapolis (15), St. Louis (21), Nashville (30), Milwaukee (34), Greenville (36), Birmingham (40), Norfolk (42), Mobile (59), Lexington (63), Des Moines (73), Paducah (80), Champaign (82), Madison (85), Cedar Rapids (89), Tallahassee (108) and Peoria (116).<sup>161</sup> Sinclair and Comcast this year negotiated retransmission consent agreements one day before the deadline - all for major market stations: Tampa (12), Pittsburgh (22), Baltimore (24), Nashville (30) and Cincinnati (33).<sup>162</sup>

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<sup>160</sup> RL34079, *supra* note 114, at 31-34.

<sup>161</sup> “Mediacom Reaches Retransmission Consent Agreement with Sinclair,” *Business Wire*, Feb. 2, 2007.

<sup>162</sup> K. Bachman, “Comcast, Sinclair Reach Four Year Pact,” *Mediaweek*, March 12, 2007.

**SUMMARY**

Marketplace solutions are ideal in situations where there is a level playing field. Negotiations can proceed in a manner that keeps costs reasonable for buyers and provides a fair return on investment for sellers. The data suggests that the retransmission consent negotiations in large markets are currently working, as neither side seems to have a significantly stronger position than the other. What is occurring in medium markets is somewhat inconclusive. Especially in those markets where cable operators have been able to cluster their systems in a market and/or region, cable operators appear to be able to stave off unreasonable demands for retransmission consent.

Clearly in the small markets (arbitrarily defined as 100-plus, yet recent impasses suggest 80-plus might be more appropriate), broadcast television stations are more likely to be in a position of power over the cable operator. One way of resolving this imbalance would be legislation to permit MVPDs located in small markets to negotiate for out-of-DMA retransmission rights. Since the purpose would be to level the playing field, the cable operator should not be permitted to negotiate with any one of 200 different stations providing the same content. A reasonable compromise might be to allow negotiation with any other television station in a market adjacent to the market in which the MVPD is located. For example, Evansville, Indiana is Market 101. The market actually includes counties in Indiana, Illinois and Kentucky. Under this proposal, a cable system located in the Evansville market would be able to negotiate retransmission consent agreements with television stations in the adjacent markets of Nashville, Tennessee, Bowling Green, Louisville or Paducah, Kentucky, or Terre Haute, Indiana. This would provide cable

systems in the Evansville market with a possible six different affiliates of each of the four major commercial television networks.

Recognize that this proposal does not guarantee cable systems a lower price for retransmission consent. In the hypothetical presented it could happen that none of the five “new” markets’ network affiliates offer any terms more acceptable to the cable operator. It could still occur that a MVPD operator ends up not providing one of the major networks’ programs because no acceptable terms are reached. If that happens, however, it will be due to market reasons and not a legislatively-created monopoly.

As stated earlier, all other things being equal those cable systems in the Evansville market are most likely to want to carry the local stations over the more distant ones. Stations from major markets (in the Evansville example, from Nashville) replacing local stations will only occur in those instances where there is an impasse in retransmission negotiations with the local stations. If the threat becomes real enough, local stations can always opt for must carry over retransmission consent.

Because the purpose of this particular proposal is to level the playing field for MPVDs in small markets, it requires that those out-of-DMA stations not be encumbered in the negotiation process. Networks are capable of exerting great power over their affiliates; so much so that the FCC once created rules limiting the authority of networks over their affiliates and protecting the autonomy of affiliated stations. A concomitant rule needs to be instituted prohibiting networks from dictating the rights of affiliated stations to negotiate with MPVDs, wherever they may be located. Thanks to actions by the networks, stations no longer have exclusivity of their network-affiliated programs.<sup>163</sup> It is beyond the scope of this paper to examine the changes that would be required to balance

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<sup>163</sup> M. Greppi, “Affils: Exclusivity is Dead,” *Television Week*, April 17, 2006.

the power between networks and their affiliates, but it is relevant to a discussion of out-of-DMA negotiation to assert that the network ought to have no explicit or implicit ability to restrict affiliates' negotiations.

The proposal must contain one additional bit of fine-tuning. In those rare examples of small markets that border only one other market, cable systems within the small market should be allowed to negotiate retransmission consent with other markets covering that state. For example, the Juneau, Alaska market ranks 207<sup>th</sup> (out of 210): one of the nation's smallest. It only borders Anchorage. Having two providers of the same content creates more of a market than the current monopoly but it's certainly not ideal. In this proposal, if cable systems in Juneau were at an impasse in negotiating retransmission deals with Juneau stations they would be permitted to negotiate with stations from Fairbanks and Anchorage. Fairbanks (Market 202) would have the same opportunity. Anchorage (Market 154) already borders both markets so the fine-tuning would not be necessary for them, but the result would be the same.

## **Remedy: Pooled Bargaining by Small Cable operators**

One potential remedy to the imbalance in negotiating power between small MVPD operators and network content providers is to allow for pooled bargaining. Under a regime of pooled bargaining small MVPD operators form an alliance that negotiates a single contract for all its members. A likely result would be a single rate per-paying customer for each of the member cable firms in exchange for the content of the network provider. By negotiating in the aggregate small operators could obtain a better “deal” than any could obtain on their own. Not only would such an arrangement likely lead to a more equitable allocation of the gains from retransmission consent agreements, but would reduce the negotiating and transaction costs for both the small MVPD providers and the network content providers.

To get a sense of this let us examine some statistical data. The National Telecommunications Cooperative Association consists of over 570 small and rural telephone cooperatives and commercial companies. According to NTCA data the average firm has 5,344 subscribers.<sup>164</sup> Many, but not all provide cable TV services to their subscriber base. Suppose that one-half of the 570 firms provide cable services, and that among those cable providers one half of their subscribers receive cable service. Some simple arithmetic tells us that the negotiator for this pool of cable operators would come to the table with over 750,000 subscribers as a bargaining chip. This would make the NTCA alliance the 10<sup>th</sup> largest cable operator in the United States.

Interestingly, the current 10<sup>th</sup> rank cable firm is Cable One which has an estimated 641,500 subscribers CableOne operates in 19 states and has 76 unduplicated locations

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<sup>164</sup> Data from NTCA website: [http://ntca.org/ka/ka-2.cfm?folder\\_id=44](http://ntca.org/ka/ka-2.cfm?folder_id=44)

from which it connects customers for service.<sup>165</sup> On average each unduplicated location represents just fewer than 8,500 subscribers. CableOne along with the other nine larger cable operators in effect are as a firm engaging in pooled negotiation for their 76 locations and 641,500 subscribers. Allowing or authorizing small MVPDs to pool their negotiating capacity mimics what larger firms are doing in currently and would offer their customers the advantages most cable subscribers currently obtain by being “represented” by a larger corporation.

Such an arrangement might require Congress to modify current anti-trust legislation to allow for a small MVPD exception. Moreover, as the problem outlined is primarily with small cable operators any legislative or administrative remedy of this nature should have a carefully thought out and crafted definition of what constitutes small. Nevertheless the intuitive appeal of the approach is obvious: it simply allows independent MVPD operators in smaller markets to pool their market power so as to obtain an outcome on par with what larger corporate cable entities are currently obtaining.

### **Transparent Pricing Requirement**

One reason for unequal bargaining in retransmission negotiation is the asymmetry in market information. A large content provider or even a local network affiliate has ready access to what is being charged for programming services. This places them at a distinct advantage to the small independent cable provider. A simple way to remedy this imbalance is to provide all market participants with data on retransmission pricing. The

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<sup>165</sup> Subscriber data From Goldfarb, p. 12 op. cit; number of outlets of CableOne calculated by author from CableOne website <http://www.cableone.net/about/locations.asp>

FCC can readily require all contracts be reported to its offices. The contractual details could be on-file and open to public access and scrutiny. Alternatively, if the FCC were persuaded that confidentiality was an overriding concern, it could easily accommodate such a concern by providing summaries and/or averages of prices and conditions found in retransmission agreements. In either case, current pricing information becomes apparent to all parties involved in retransmission negotiations.

## **An Assessment of Technological Resolutions on the Horizon**

**Introduction:** Before divestiture, the best way to think of the communications sector was as distinct vertical rather than horizontal layers. The telephone, cable, computing, and consumer electronics industries on the whole operated separately from each other. For example, there was no competition in wire line services for residential customers, telecommunication companies manufactured telephone handsets; built, owned and operated the networks along which voice signals were transported; and managed the ways in which these signals were transported across the networks<sup>166</sup>.

Prior to 1984, cable firms were technically limited to the provision of video entertainment, there were no cellular telephone companies, the Internet was largely dedicated to military and research university applications, consumer devices were restricted to a single function, and VoIP wasn't even an acronym. This has all changed as the migration from analog to digital across all industries has changed the communication fabric of America.

**Digital Convergence:** Over the past ten years, more competition across multiple layers (voice, data and video) has driven an acceleration of innovation and a dramatic reduction in both prices and costs for consumers. Faster chip sets, higher transport capability, coupled with a common Internet standard (IP), have set up a collision of three previously separate industries. And over time, the lines that previously distinguished one

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<sup>166</sup> Mueller, M. 1999 Digital convergence and its consequences available at <http://dcc.syr.edu/miscarticles/rp1.pdf>

industry from another have become blurred, soon to be non-existent. The recent unbridled evolution of digital technology, coupled with its rapid growth in the marketplace, have eroded the distinctions between telephone company, cable firm, broadcast media, and internet service provider. Today it is easy to envision a time when information firms (AT&T, Comcast, Disney, CBS, etc.) will be classified as transport providers, content providers, or some hybrid, and we will no longer refer to them as simply telephone or cable firms.

We've entered a digital age where consumer electronic devices (phones, TV's, computers, etc.), both wired and wireless, can handle voice, data and video streams. At the "user" end, devices are no longer restricted to a single function. According to Gottfried Dutine, an executive VP at Royal Philips Electronics, "Convergence is finally really happening." He adds, "Digitization is creating products that can't be categorized as tech or consumer electronics. The walls are coming down."<sup>167</sup>

**Telecom Technology Push:** The "technology push" is the results of a number of dynamic factors which have impacted the new digital landscape. Back in 2001, James Crowe, Level 3 Communications CEO, said, "The telecommunications industry is in the middle of a migration to optical, IP-based infrastructure designed to carry broadband traffic."<sup>168</sup> Over time, increased demand for consumer services continue to dictate new

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<sup>167</sup> "Big Bang: Digital convergence is finally happening – and that means new opportunities for upstarts and challenges for tech icons," Business Week, June 21, 2004. Available at [http://www.businessweek.com/magazine/content/04\\_25/b3888601.htm](http://www.businessweek.com/magazine/content/04_25/b3888601.htm)

<sup>168</sup> CSFB Global Telecommunications CEO Conference, March 5-7, 2001, New York. Available at <https://tech.csfb.com/telecom/environment.htm>.

and revolutionary approaches to network design and transport capabilities that transcend the traditional cable television and telephone industries.

Cable television systems began the migration to hybrid fiber-coax (HFC) systems in the early 1990's. Today, as an increasing volume of interactive services (Internet, VoIP, VOD, etc.) are added to the traditional broadcast video suite, cable systems explore ways in which to increase the useable bandwidth per user. The anticipated migration to full broadcast digital content<sup>169</sup> and an increased demand for new, interactive customer services dictate cable systems plan for and deploy digital compression and transmission, larger pipes and reduced subscribers-per-node counts in their future network designs. In the end, new generation optoelectronics, including the deployment of SONET (Synchronous Optical Network) multiplexers and wave division multiplexing (WDM), offer cable systems the necessary increased bandwidth, speed and optical routing capability to meet current and future consumer demand.<sup>170</sup>

Likewise, incumbent local exchange carriers (ILECs) have no choice but to invest in new technology and infrastructure that allow high-speed broadband and video content to stay in the game. The primary reason rests with the impact of competing digital technology and industries on the core "phone" business. Dr. Lawrence Vanston, president of Technology Futures, Inc., wrote, "Wireless, cable telephony, and VoIP continue to erode the traditional voice market and destroy the value of traditional ILEC assets such as copper cable and circuit switches. We forecast that by 2010, ILEC narrowband access lines will have fallen to 71 million down from a peak of 187 million

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<sup>169</sup> The Digital Television and Public Safety Act of 2005 (DTV Act) set a firm deadline of February 17, 2009, for the completion of the DTV transition.

<sup>170</sup> See "Hybrid/Fiber Coax (HFC) and Dense Wavelength Division Multiplexing (DWDM) Networks," available at [http://www.iec.org/online/tutorials/acrobat/hfc\\_dwdm.pdf](http://www.iec.org/online/tutorials/acrobat/hfc_dwdm.pdf).

in 2000.”<sup>171</sup> Data show the traditional landline telephone business is contracting, and the competitive pressure to upgrade facilities has become a matter of economic necessity.

Thus, telephone firms must enable themselves with broadband technology in the network to be competitive with a multitude of outside firms; each offering new services differentiated not only by content but also by delivery technology. While switching and transmission in the telephone network have been converted to digital, the primary link to the customer remains twisted pair copper. That’s the bad news. The good news is that there is technology available that can, on the short term, use the existing “last mile” copper infrastructure to support most high-speed services.

Increasing bandwidth is now mandatory for ILECs, but the best way to do it depends on a number of factors, not the least of which is selecting the correct network design that matches equipment deployment expense with expected revenue from new mix of competitive services (voice, data, and video). Looking forward, a 2006 report by Technology Futures, Inc. (TFI) predicts that by 2010, about 75% of U.S. households will have broadband service, and about 12% of households will subscribe to very high-speed broadband, at least 24 Mbps.<sup>172</sup> This suggests broadband service providers must have the capability to handle multiple simultaneous services (high speed data, voice, and video), including high definition television.

**Digital Subscriber Loop (DSL):** In response, many telephone firms are upgrading their copper networks with fiber to the premises (FTTP) or fiber to the

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<sup>171</sup> Lawrence Vanston, Ph.D., "Transforming The Local Exchange Network: Third Edition," Technology Futures, Inc. (March 9, 2006).

<sup>172</sup> Lawrence Vanston, Ph.D., "Transforming The Local Exchange Network: Third Edition," Technology Futures, Inc. (March 9, 2006).

neighborhood (FTTN) and some version of xDSL technology to communicate from the Digital Subscriber Line Access Multiplexer (DSLAM) to the household. This upgrade alone places telephone carriers squarely in a competitive position for the provision of broadband Internet services. While cable modems still attract the majority of broadband subscribers in America, DSL deployment is close behind. In fact, DSL subscribers are expected to exceed cable subscribers by early 2008.<sup>173</sup>

According to the FCC's most recent report on high-speed services for Internet access, released January 31, 2007, of the 64.6 million total high-speed lines reported as of June 30, 2006, 50.3 million served primarily residential end users. Cable modem service represented 55.2% of these lines while 40.1% were asymmetric DSL (ADSL) connections. The report went on to state ADSL lines increased by 3.1 million lines during the first half of 2006 compared to an increase of 2.0 million lines for cable modem service. For the full year, ADSL increased by 6.3 million lines compared to an increase of 4.6 million lines for cable modem service.<sup>174</sup>

While there are multiple DSL technologies, there are only two that are the focus of most DSL deployments, asymmetric DSL (ADSL), and very high bit rate DSL (VDSL), the most powerful of the xDSL family. The technology and network architecture utilized will dictate the type and quantity of services offered.

For carriers deploying conventional ADSL, the distance from the Digital Subscriber Line Access Multiplexer (DSLAM), normally at the central office, to the subscriber household will determine the maximum data transmission rate. Carriers can increase penetration by deploying a fiber to the neighborhood (FTTN) architecture, with

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<sup>173</sup> "USA – Broadband Market – Cable modem & DSL – Analysis, Statistics & Forecasts," April 13, 2007, available at [www.budde.com.au](http://www.budde.com.au).

<sup>174</sup> Available at [www.fcc.gov/web/stats](http://www.fcc.gov/web/stats).

powered DSL modules (DSLAM) installed at nodes closer to customers. By using a combination of fiber and remote DSLAM's to reach the overwhelming majority of homes, carriers can preserve the use of the existing copper infrastructure and eliminate trenching in the last mile. Proximity to the end user is one element, but a high transport speed is also required to provide some newer services.

Using conventional ADSL, you can achieve a maximum data rate of 8 Mbps for copper runs of less than 14,000 feet in length, dropping to 1.5 Mbps at 18,000 feet. This is sufficient for high-speed Internet access, but insufficient to transport video. Small improvements in data rates can be achieved by using ADSL2, or significant improvements under ADSL2+, which virtually doubles the data rates possible at nearly one mile or less.<sup>175</sup>

The table below shows the comparison between ADSL2 and ADSL2+ maximum data rates downstream.

Comparing ADSL2 and ADSL2+ Maximum Data Rates (Mbps) Downstream		
Local Loop Distance (ft)	ADSL2 (Mbps)	ADSL2+ (Mbps)
1,000	12.5	26.0
2,000	12.5	26.0
3,000	12.5	25.5
4,000	12.5	24.5
5,000	12.5	20.0
6,000	11.0	15.5
7,000	10.0	12.5
8,000	9.5	9.5
9,000	7.5	7.5
10,000	6.0	6.0

Source: Gilbert Head, Understanding IPTV (Boca Raton, FL: Auerbach Publications, 2007), p.29.

<sup>175</sup> There are 5,280 feet in a mile.

If you use ADSL2+ and the technical benchmark is the capability of delivering multiple services at a minimum of 24 Mbps, then the remote DSLAM must be located a maximum of 4,000 feet from the subscriber household. Some improvement is possible with the use of copper bonding, which uses two copper strands instead of one. For example, ADSL2+ technologies, which will allow the carrier to offer about 12 Mbps of capacity on a single copper strand at 7,000 feet, can theoretically boost capacity to up to 24mbps. However, to achieve even higher throughput speeds, most carriers are looking to deploy very high rate DSL (VDSL) technology.

First, VDSL is approximately ten times faster than conventional ADSL, and is considered ideal for transporting video to the neighborhood, to the curb, or to the household. Using frequencies above those for telephone service on the existing twisted pair, VDSL can achieve speeds up to 50 Mbps downstream over short distances of approximately 1,000 feet or more. Actual throughput speed is, as with all xDSL technology, distance sensitive and related to the diameter of the twisted pair used in the plant. Assuming a worst case scenario, a telephone plant with existing 26-gauge (AWG) twisted pair can handle a VDSL transmission rate of approximately 50 Mbps downstream and up to 30 Mbps upstream at 1,000 feet. By increasing the wire diameter to 24-gauge or 22-gauge, you can achieve similar throughput speeds at slightly longer distances.<sup>176</sup>

If you believe, as most do, that the network design benchmark requires the capability of delivering up to 30 Mbps to households, then the new VDSL2 standard, ratified by the ITU in 2005, is the choice. First, VDSL2 offers data speeds and bandwidth needed for next-generation services, but, just as importantly, it offers

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<sup>176</sup> Gilbert Head, *Understanding IPTV* (Boca Raton, FL: Auerbach Publications, 2007), pp 116-117.

provisioning flexibility that is imperative to a service provider's ability to cost-effectively roll out new service offerings and generate new revenue streams. Network operators like AT&T, Qwest and others are already using different types of VDSL2 deployments in combination with fiber optic technology. Prior to acquiring AT&T, SBC originally set a target of 30 Mbps at 6,000 feet, enough to simultaneously deliver one high definition channels, two standard definition channels, two voice-over-IP channels, and still have enough throughput for high-speed Internet service.<sup>177</sup> While that goal may have been ambitious, depending on the quality of the twisted pair, distances of 2,300 to 2,800 feet are common today from the Video Ready Access Device (VRAD) box, the neighborhood node containing the DSLAM, to the customer premises.

The table below shows a comparison of competing technologies for typical downstream and upstream throughput speeds. It demonstrates that as an interim solution, VDSL technologies will allow carriers to offer high-speed services over existing last-mile copper loops, while postponing the necessity of trenching fiber to every household at a cost of \$3,000 to \$10,000 per subscriber. These newest technologies, like VDSL2, also

Service Comparison of Technology Options				
		First Generation Broadband		
	Dial-up	DSL	Cable	VDSL/VDSL2
Typical Downstream	56 Kbps	1 Mbps	3 Mbps	50 Mbps – 100 Mbps
Typical Upstream	56 Kbps	256 Kbps	256 Kbps	30 Mbps – 50 Mbps
Service Provider	Carrier	Carrier	Cable Operator	Carrier

Source: Richard Sekar, "New VDSL2 Standard will Bring Fiber-Fast Broadband," Convergent Network Digest (January 21, 2005).

<sup>177</sup> Vince Vittore, "Carriers Get Their Wishes: ITU Approves VDSL2 Standard," Telephony Online (June 6, 2005).

offer tremendous new capabilities not only for their inherent carrying capacity all the way to the end user, but also because of their flexibility for use with newer architectures and topologies.

**Television over IP (IPTV):** For carriers, the most complex and technically challenging addition to the competitive mix is the provision of video service. High bandwidth and throughput speed requirements, even with compression, complicate network design considerations. Deploying fiber in the network, selecting an appropriate xDSL technology capable of high-speed throughput, and moving the DSLAM's closer to the end user are only three parts of the equation. The fourth element is the platform used to deliver multiple high-speed broadband services, including video, over the network infrastructure. Television over IP (IPTV) can be a viable technical and economic choice.

IPTV is a system where a digital television service is delivered by using Internet Protocol (IP) over a network infrastructure via the broadband connection, usually via a private, managed network rather than the public Internet. Rather than video delivery through traditional over-the-air broadcast, satellite or hybrid fiber/coax cable systems, television is received by the viewer through the technology originally designed for computer networks. However, there's more to the story than simply moving video from traditional broadcast and cable networks to IP networks.

Television over IP promises to be the most logical and economical path for carriers to become and remain competitive with other "triple play" service providers.

Gartner predicts the number of IPTV subscribers will grow from 3 million in 2005 to 50 million in 2010.<sup>178</sup>

Delivering all services via IP has a number of strategic advantages for both content and functionality. First, using IP routers and Ethernet switches can be done at a lower cost compared to alternatives. In a typical cable television system, all the traditional video content constantly flows downstream from head end to each subscriber, and the customer selects which program to “grab” from this large stream by using the set-top box. The total number of customer choices are dictated by the size of the cable pipe, 860 MHz for example, and limited to the number of compressed programs the cable operator can “squeeze” into this bandwidth. A switched IP network works differently in that content remains in the network, and is only transmitted to the household when selected by the customer. Not only does this free up bandwidth but “customer choice” is, in theory, only limited by the size of the pipe running to the household and the library of programming and information stored on servers throughout the network.

Second, IP allows for interactivity by putting the user in control and making the viewing experience more interactive and personal. Because IPTV is primarily a software solution, viewer enhancements are easily enabled. For example, an electronic program guide which allows viewers to search for content by title or actor’s name, or a picture-in-picture (PIP) browse feature that allows viewers to channel surf without leaving the program they’re watching, or viewing multiple camera angles of live event programming, are all possible on a single screen. Additional functionality, like using your computer or a wireless phone to remotely control a DVR player to record up to four simultaneous programs while you’re away is also possible.

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<sup>178</sup> <http://www.microsoft.com/tv/content/Press/PressReleases/mediaroomQandA.msp>

Third, a common IP platform is about making things work together. This means that any services delivered over the IP-based network represent new opportunities for integration and convergence. Convergence implies interaction of existing services in a seamless manner to create new “value added” services from the carrier. One example would be the interaction of the television and the digital phone. Allowing “Caller ID” to appear on the television screen allows the viewer to identify the caller, and provides the option to answer the call, ignore the call, or send it to voice mail. Another example would be the interaction of the television and the Internet. While watching a program, a viewer can conduct background searches on actors, players, events or gather other statistics without leaving the program. Using a common IP backbone to integrate services, tie them together, provides consumers anytime-anywhere access to a world of content over the televisions.

Finally, given a robust and versatile network architecture, there is the economic and strategic advantage of “bundling” multiple, competitive services over a single pipe, the triple-play, which can be marketed as a package and offered to customers at a reduced rate. These new revenue streams from content and value added services are essential to counter continued erosion of the traditional voice market. Gartner recently surveyed Western European consumers as to what were the top factors that would influence a move from a single-service to triple play provider. Not surprising, price, convenience, and speed, were the top three buying criteria for triple-play.<sup>179</sup> Using a common, high-speed IP-network allows telco carriers to offer multiple services and be competitive

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<sup>179</sup> “Gartner Says Triple Play is Here to Stay but Warns that it May Not Immediately Boost Operator Revenue,” Gartner, May 10, 2005. See [http://www.gartner.com/press\\_releases/asset\\_126904\\_11.html](http://www.gartner.com/press_releases/asset_126904_11.html).

across each buying criteria and to close the triple-play gap with cable television and other service providers.

**Ancillary Technical Issues:** There will always be a stream of new technical solutions that, often as not, are in search of a problem. One case in point is the March 2007 proposal by CableLabs®<sup>180</sup> to develop specifications for an interface which will allow receipt of off-air digital broadcast signals. According to a recent CableLabs® news release:

The interface specifications would enable devices to receive digital off-air television signals and would deliver these digital signals seamlessly through a cable set-top box. This technology would allow consumers to receive broadcast television signals as an integrated viewing experience. The concept combines over-the-air digital television transmission with television programming carried by the cable provider.<sup>181</sup>

In short, what's proposed is a modern version of the classic A/B input switch. Various methods of providing cable subscribers with access to over-the-air broadcast signals have been explored over the past 20 years. In 1988, for example, the Federal Communications Commission (FCC) initiated new regulation that would require cable television system operators to provide an "A/B switch" which would allow cable subscribers access to off-the-air television stations, particularly those no longer required to be carried on the cable system. Congress subsequently abolished this FCC requirement in 1992, and stated that an A/B switch was not an enduring or feasible method for reception of television signals.<sup>182</sup> Further, the FCC later questioned whether

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<sup>180</sup> CableLabs(r) is a non-profit R&D consortium, backed by the cable television industry, and dedicated to pursuing new cable telecommunications technologies.

<sup>181</sup> [http://CableLabs\(r\).net/news/pr/2007/07\\_pr\\_offair\\_030107.html](http://CableLabs(r).net/news/pr/2007/07_pr_offair_030107.html)

<sup>182</sup> Pub. L. No. 102-385, 106 Stat. 1460

it even had the authority to address the A/B switch issue, regardless of the prohibitions of the 1992 Cable Act.<sup>183</sup>

The issue of whether the application of an A/B switch would impact “must carry” obligations under the 1992 Act was later addressed in the 1997 Turner case. Here the Supreme Court held:

In any event, a careful examination of each of appellants' suggestions--a more limited set of must carry obligations modeled on those earlier used by the Federal Communications Commission; use of so called A/B switches, giving consumers a choice of both cable and broadcast signals; . . . and a system of antitrust enforcement or an administrative complaint procedure--reveals that none of them is an adequate alternative to must carry for achieving the Government's aims.<sup>184</sup>

The A/B switch technology proposed by CableLabs® does not address the statutory and regulatory public policy issues surrounding must carry, but it can augment the convenience of choice that many consumers already enjoy. The fact is most newer NTSC television sets already have a built-in A/B switch which allows consumers to toggle between off-air television reception and cable stations by using their remote control. In the case of newer digital television “monitors”, those without built-in tuners, the proposed CableLabs® all-in-one cable set-top design with off-air input would offer a convenient, one button, solution for future cable subscribers. For those who elect to keep their analog NTSC television receivers past the February 2009 digital cutover date, a separate digital-to-analog converter box will be required.

For those television households comfortably within the Grade A and Grade B contours of local stations, the A/B switch option could impact future negotiation over

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<sup>183</sup> In the Matter of Carriage of the Transmissions of Digital Television Broadcast Stations, Notice of Proposed Rulemaking, CS Docket 98-120, FCC 98-153 (released July 10, 1998).

<sup>184</sup> Turner Broadcasting System, Inc. v. F.C.C. (95-992), 520 U.S. 180 (1997).

must carry and retransmission consent. There are, however, a number of critical caveats. First, the mere refusal to carry local broadcast outlets involves some risk. There is the assumption that consumers will readily embrace the necessity of switching to an outside video input to receive local, off-air television stations. Down the road, the popularity of this option will depend, to a large extent, on the ability of each respective household to receive an acceptable off-air, “digital” television signal using an indoor or rooftop antenna.

Second, in more remote or rural areas within each DMA, where “local” service is often at the fringe of the current Grade B contour, an acceptable off-air television signal might entail the added expense of the erection of a tower at each household. If the inconvenience and cost of erecting a tower to receive off-air signals exceeds the value and convenience of switching to a competitive MVPD outlet, this off-air alternative to must carry may be counterproductive.

## About the Authors

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Umansky has represented radio and television clients on a wide variety of regulatory and legal issues. He also has represented broadcast and technology trade associations on regulatory, policy and judicial matters. He speaks before national and state electronic media associations on broadcast and communications topics and has been a regular contributor of articles in national magazines covering the broadcast industry.

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