



THE FREE STATE FOUNDATION

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Perspectives from FSF Scholars
June 18, 2012
Vol. 7, No. 12

**Accelerate New Video Breakthroughs
by Rolling Back Old Regulations**

by

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The FCC is now preparing to release its *Annual Video Competition Report*. This much-delayed report should contain some up-to-date numbers regarding competitive conditions in the video marketplace.

Despite the FCC's failings over the last several years in preparing its video reports and meeting Congress's deadlines, the video market continues to undergo rapid transformation and become more competitive. Recent publicly available data as well as the everyday experience of consumers point to the competitiveness of today's video market. Consumers' choices typically include video service offerings from local cable operators, two nationwide direct broadcast satellite (DBS) providers, traditional telephone companies that have entered the market as multichannel video programming distributors (MVPDs), and over-the-air broadcast TV stations. Increasingly, consumers are accessing and enjoying video content made available by wireless operators. And now there are a growing number of online video distributors (OVDs) in the marketplace. All the while, new types of service offerings continue to roll out.

But even as competition and innovation in the 21st Century video market advances, there are pro-regulatory advocates urging that still more restrictions be placed on cable,

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DBS, and other video services. When analyzed closely, most of the proposals smack of common carrier-like regulation that prevailed last century when communications providers possessed dominant market power. If viewed properly, they all involve access or forced sharing mandates and/or rate regulation that characterize common carrier regimes.

Consider just how much the FCC already over-regulates video services. For instance, the FCC's **Retransmission Consent and Must-Carry regulations** require either that MVPDs carry broadcast content on basic tier channels or that before carrying such content they must bargain only with local broadcasters in a controlled setting. The FCC's **Program Carriage regulations** restrict MVPDs' ability to negotiate terms and prices with independent video programmers who want their programming to be carried on cable networks. The FCC's **Program Access regulations** restrict the ability of MVPDs that own video programming content from freely negotiating terms and prices in making their content available to other MVPDs. The FCC's **Leased Access regulations** restrict the ability of MVPDs to determine the content carried and the prices for making available channel capacity on their own cable networks by requiring channel set asides subject to rate controls. And the FCC's **Cable Set-Top Box regulations** restrict cable operators' design and use of video devices for lease to cable subscribers, among other things by prohibiting single devices from including both channel navigation and security functions. Other federal, as well as state or local, regulations also restrict cable operators and other MVPDs in providing service to consumers.

It's becoming increasingly obvious that the current regulations that now saddle the video market do not square with the reality of the competition that exists. But other types of regulations restricting new video service offerings are now being considered by the FCC or urged by pro-regulatory advocates. The FCC's proposed **"AllVid" regulations** would expand its set-top box regulations and extend new design specification requirements to all video navigation devices made available by MVPDs, including devices capable of viewing content downloaded via the Internet.

Also, advocates for new regulation recently have argued that the FCC's **network neutrality regulations** applicable to broadband Internet service providers should extend to cable video services or to other "specialized services" that are claimed to compete with OVDs that "ride on top" of the broadband providers' facilities without payment of any usage charges. The U.S. Department of Justice is even reported to be investigating cable and satellite operators in connection with their treatment of online video services. These developments are troubling.

It is certainly possible, even likely, that if government authorities take an overly rigid view of "neutrality" or "nondiscrimination" requirements, whether stemming from the FCC's net neutrality regulations or from "nondiscrimination" provisions in consent decrees, new investment in broadband facilities and new investment in programming will be discouraged. After all, the MVPD providers have invested hundreds of millions of dollars in constructing broadband network facilities and in procuring a remarkably diverse array of programming to deliver to their subscribers. If these MVPDs are not

allowed to capture a market-based return on their investment because the government, in the name of enforcing neutrality mandates, treats them as if they were traditional regulated common carriers, it is unrealistic to believe they will continue to have the incentive to invest.

The FCC should comply, of course, with Congress's existing mandate in preparing annual video competition reports. So a report shedding new light on the competitive conditions of the video market, if done properly and without prejudice, is welcome. Even better would be an annual report by the FCC analyzing the wireless, video, and broadband markets in a combined, comprehensive report that takes convergence and cross-platform competition into account. A bill now advancing through Congress would require such a unified competition report.

But as we await the FCC's video competition report, we here offer a video regulation report, showing how several regulations based primarily on early 1990s assumptions about the cable market are ill-suited to today's market and a hindrance to the developments we want to see in the future. Stacking even more regulatory restrictions on top of the existing rules would only further hamper the ability of MVPDs to deliver innovative new video service offerings.

The imperative of federal communications law and policy should be finally to roll back legacy regulations that impede investment and innovation by MVPDs and to ensure that no monopoly-era common carrier-like regulations are imposed on any video service distributors. A free market offers the optimal set of conditions for continued investment in new broadband network facilities and for the next wave of breakthrough innovation in video services delivered to consumers.

And, importantly, a free market for video distributors is also consistent with free speech guaranteed by the First Amendment.

FCC's Suspect Reporting on Cable and Video Competition

Congress requires the FCC to annually prepare a report on the competitiveness of the video services market.¹ The FCC typically relies on the data it collects in its Video Competition Report for its policymaking activities. How the FCC frames the data contained in its reports typically foreshadows the future direction of its policymaking activities, with significant consequences for the regulation of different video services.

In recent years, the FCC has repeatedly failed to meet Congress's requirement. The last Video Competition Report released by the FCC was based on data and information up to 2006.² That last report was itself woefully delayed, not being released until 2009.³ And serious questions regarding manipulative use of data and strong agency bias in that report have called its reliability into question.⁴

Unfortunately, the current FCC also missed repeated yearly deadlines for preparing the annual Video Competition Report. The report that the FCC is now working on will be the first such report prepared and released during the current Administration.

But as the public awaits the release of this new report on the competitive climate of the video services market, it is important to take stock of marketplace developments leading up to this report as well as the regulatory atmosphere in which that market now exists.

Today's Dynamic Video Services Market

Much of today's extensive regulatory apparatus governing cable services is based on the 1992 Cable Act.⁵ In passing the Act, Congress was motivated by what was then perceived to be a "bottleneck" for video distribution. It charged the FCC to impose restrictions on several aspects of the video services market to address its concerns of the so-called bottleneck.

From a consumer's standpoint there can be no dispute that the video marketplace of 2012 is drastically different from 1992. Rapid innovation and vibrant competition give consumers more choices for video programming and services than at any other time. And while the FCC's forthcoming Video Competition Report may provide some updated numbers corroborating the market's dynamism in terms of overall market trends, the growth and competitiveness of new video services and choices is already confirmed by publicly available data.

With two major DBS providers offering nationwide service, and firms formerly regarded as telephone companies rolling out their own MVPD services, consumers are in many instances able to choose between two, three, or even four competing video service providers. Whereas cable operators controlled approximately 95% of the national market for video programming subscribership in 1992, cable's market share had fallen to about 60% of video subscribers in 2010.⁶ DBS providers serve over 30 million subscribers.⁷ Telco entrants serve approximately 6.5 million.⁸

The vertical dimension of the video programming market has also changed significantly. The number of vertically integrated video programming has declined from more than 50% of all cable programming in the 1990s to less than 20% today.⁹ And the number of unaffiliated video programming choices available to consumers has also grown significantly in recent years.¹⁰

Meanwhile, OVDs offer even more video programming choices. In addition to online services such as iTunes, Netflix's subscription service, and Amazon Prime, Hulu and a number of individual broadcast and cable TV programmer websites offer streaming content to consumers for free by using ad-supported models. Broadband-connected video game consoles such as Sony PlayStation 3 and Xbox 360 are also increasingly popular devices featuring video content applications. "Smart TVs" capable of accessing video content directly from the Internet have been brought to the market. Roku, Boxee, and Apple TV also offer content delivery services through their respective new devices.

There are indications that many consumers are now relying on a combination of online video delivery and over-the-air TV using rabbit ear antennas as an alternative to cable video or DBS subscriptions.¹¹ And new broadband-enabled tablet devices and smartphones are giving consumers mobility options for streaming and downloading video.

FCC Regulations for Cable Video Services

Despite the sweeping changes in the video marketplace that have eviscerated concerns from the 1990s, regulations of video services premised on bottlenecks continue unabated. An overarching view of the scope and extent of FCC regulations gives one a glimpse of just how restrictive the current regulatory apparatus governing video services remains.

In passing the 1992 Cable Act, Congress directed the FCC to impose restrictions on several aspects of the video services market. And since passage of the Satellite Home Viewing Improvement Act of 1999, DBS providers are under many of the same mandates as cable operators.¹²

Consider first the FCC's ***Retransmission Consent and Must-Carry regulations***. Congress sought to "protect" broadcasters in local broadcast markets from competing content offered by cable operators or from retransmission of out-of-market broadcasting content. Broadcasters may compel MVPDs to carry their broadcast content on a basic tier channel. The broadcaster simply has to declare its content "must-carry" to invoke its statutory program carriage rights against MVPDs.¹³ Congress mandated that the "must-carry" broadcaster picks which particular channel must carry its content.¹⁴

Alternatively, broadcasters can forego "must-carry" and instead opt to negotiate directly with MVPDs for retransmission of their broadcast signal.¹⁵ But MVPDs are again restricted from freely negotiating. The FCC's network non-duplication regulations allow local stations to block MVPDs from importing network programming from another affiliate of the same broadcast network, even if the out-of-market broadcast affiliate and the cable operator could otherwise reach agreement.¹⁶ Similarly, syndicated exclusivity regulations allow local stations providing syndicated broadcast programming to prevent MVPDs from carrying the same programs broadcast by out-of-market broadcast stations.¹⁷

The artificial statutory and regulatory constraints mentioned above have the effect of conferring certain advantages that may work to the negotiating advantage of broadcasters and against the MVPDs. In recent years, rising broadcast retransmission fees have been the source of increasing friction between broadcasters and MVPDs negotiating over rights to retransmit broadcast signals. MVPDs paid approximately \$738 million to broadcasters in retransmission fees in 2009, with the amount predicted to increase to as much as \$1.6 billion by 2015.¹⁸

On June 12, the FCC sunset most aspects of its viewability rule, an appendage to its must-carry regime adopted as a temporary measure to facilitate the DTV transition.¹⁹ However, the extensive retransmission consent and must-carry regulatory apparatus remains firmly in effect.

Then there's the FCC's ***Program Carriage regulations***. The 1992 Cable Act requires the FCC to regulate program carriage agreements between vertically integrated cable operators or other MVPDs such as DBS providers and independent or unaffiliated video programmers.²⁰ The FCC's rules prohibit program carriage agreements that either require independent video programmers to have a financial interest in a network as a condition of carriage or that coerce unaffiliated programmers into providing an MVPD exclusive rights to programming.²¹ They also prohibit agreements containing provisions that "unreasonably restrain the ability of an unaffiliated video programming vendor to compete fairly by discriminating in video programming distribution on the basis of affiliation or nonaffiliation of vendors in the selection, terms, or conditions for carriage."²²

Keep in mind that the number of unaffiliated video programming networks available to consumers has also grown significantly in recent years. In fact, the number of vertically integrated video programming networks has declined to less than 20% today.²³ Yet the FCC has shown no interest in scaling back its regulatory activity in this area. Instead, it has issued a proposed rulemaking that would expand its program carriage regulatory regime.²⁴ And so government second-guessing of prices and service terms arising from private bargaining continues, despite the increasingly competitive market conditions.

MVPDs are also subject to the FCC's ***Program Access regulations***. The 1992 Cable Act directs the FCC to impose program access requirements on vertically integrated MVPDs in order to limit their ability to withhold satellite programming from competitors in the video distribution market. Program access rules make it unlawful for vertically integrated MVPDs "to hinder significantly or to prevent any multichannel video programming distributor from providing satellite cable programming or satellite broadcast programming to subscribers or consumers."²⁵ Among other things, vertically integrated MVPDs are prohibited from discriminating between MVPDs in the sale of their programming.²⁶ And exclusive contracts for satellite programming between MVPDs and vertically integrated satellite programmers are generally barred.²⁷

Prompted in part by a decision by the D.C. Circuit, in March the FCC did seek public comment on a possible sunset of its exclusive contract prohibition rather than grant another extension of the prohibition.²⁸ So far, however, the current FCC expanded its program access mandates. A 2010 order declared that denying access to what it called "must-have" terrestrial programming – principally regional sports networks (RSNs) – could discourage alternative MVPDs from entering new markets or from providing competitive alternatives.²⁹ The result is a continuation of a policy that limits contractual freedom in the market. The program access and accompanying complaint rules allow the FCC to restrict prices by second-guessing the bargaining positions of marketplace competitors.

The FCC's **Leased Access regulations** impose additional burdens on MVPDs. The 1992 Cable Act continued, in modified form, the FCC's earlier leased access regulations requiring MVPDs to set aside a certain percentage of their channels for use by unaffiliated programmers.³⁰ MVPDs must make channel capacity available by establishing "the price, terms, and conditions of such use which are at least sufficient to assure that such use will not adversely affect the operation, financial condition, or market development of the cable system."³¹ Under the statute, MVPDs lose "editorial control over any video programming" on the leased channel capacity.³² Moreover, the prices and terms offered by MVPDs are subject to FCC controls.³³

The stated purpose of leased access requirements is the promotion of video programming and the dissemination of independent information sources to the public "in a manner consistent with the growth and development of cable systems."³⁴ But the forced-access and price control restrictions are hardly defensible in light of the remarkable development of video distribution competition and alternative sources of content. Competition from satellite and telephone video distributors, online video delivery, and other sources likewise makes it unlikely that any anticompetitive harm exists requiring such restrictions.

In addition, cable operators are subject to a slate of **Cable Set-Top Box regulations**. In 1996, when cable operators were still more widely regarded as retaining market power, Congress included a provision in the Communications Act regarding the design, compatibility and functionality of set-top box devices for cable video services. Congress required the FCC to adopt regulations to promote the availability of set-top devices from vendors unaffiliated with cable operators.

Congress also directed the agency to sunset the regulations when the market became effectively competitive. But despite this competitive environment for video services and video device options, the FCC has declined to use its authority to sunset its set-top box regulations. It continues to enforce its CableCARD regulatory regime regarding set-top boxes. This includes FCC enforcement of its regulation prohibiting set-top boxes from containing both navigation and security functionality, a technical device design mandate not expressly required by statute.³⁵

Coming to Cable: Even More FCC Regulations?

Of course, video services are subject to a number of other regulatory mandates. But if the existing regulations described above weren't enough, pro-regulatory advocates are now urging new regulatory mandates be imposed on emerging video services offered. For its part, the FCC is also looking to impose additional regulations on MVPDs. And DOJ is now reportedly investigating cable operators and OVD competition.

For starters, the FCC is seeking to double-down on its regulation of video devices. At the core of its proposed **"AllVid" device regulations** is a requirement that all MVPDs use and make available to subscribers a special "adapter."³⁶ This AllVid adapter must operate as a "set-back" device containing functionalities such as access, provision,

decoding, and reception to connect to all video navigation devices (including those manufactured by companies unaffiliated with MVPDs).³⁷ Alternatively, MVPDs must use an AllVid adapter as a "gateway" device for allowing all consumer electronic devices to access MVPD services.³⁸

The FCC hopes that AllVid will facilitate such access by creating a nationwide interoperability standard to accommodate any delivery technology used by an MVPD and also allow unaffiliated manufacturers to design interfaces that integrate with any delivery technology.³⁹ This includes allowing unaffiliated manufacturers to add additional functionalities to the devices, such as "manipulating the channel guide, providing more advanced parental controls, providing new user interfaces, and integrating with mobile devices."⁴⁰

Manufacturers design devices with all kinds of functionality trade-offs in mind. Balancing complex technological and financial constraints requires freedom to experiment and innovate. But AllVid mandates extend to the hardware, logic, applications, and content layers of video navigation devices, all of which will involve implementation costs. The burdens that AllVid would place on MVPDs would therefore be substantial, especially when less intrusive alternatives are surely available.

Designing commercial media technologies and devices should not be the business of Congress or bureaucrats. This is especially so in markets where innovation is constant and technical mandates are quickly rendered obsolete by market developments. And there is no substantial evidence that pervasive regulation of video navigation devices and aspects of MVPD services would provide consumers access to programming or information sources.

Fortunately, video services were generally exempted from the FCC's **network neutrality regulations**. Unfortunately, however, innovative new video delivery offerings by vertically integrated as well as independent OVDs are now coming under increasing threat of new regulations.

The FCC's net neutrality restrictions were focused primarily on management of broadband networks. But the FCC asserted that its rules will also encompass "any service that the Commission finds to be providing a functional equivalent" to broadband service or any service that the FCC believes is being used to evade its rules.⁴¹ The FCC stated that services used as a substitute for broadband Internet access or services that allow some uses of the Internet but not others are factors it will consider in determining whether a service is used to evade its rules. The FCC also maintained that "specialized services" such as Internet Protocol-based video offerings "may raise concerns" about bypassing its rules.⁴² The FCC explained it would "proceed incrementally" with respect to such services, carefully monitoring them as well as "any arrangements a broadband provider may seek to enter into with third parties to offer such services."⁴³

Pro-regulatory advocates would apparently prefer to see the FCC move more immediately than incrementally to regulate OVDs. They have recently complained that

cable operators are somehow working around the FCC's net neutrality rules with certain new video offerings. Comcast's agreement with Microsoft for Xbox360-using Comcast subscribers to stream video content through their Xbox devices has been a notable target of criticism. The Xbox-accessible video content rides through Comcast's private cable network. Of course, Comcast's cable network is an MVPD service subject to the list of legacy regulations listed above rather than net neutrality regulations. So Comcast doesn't count that content towards their subscribers' broadband Internet data usage the way they count streaming content from Netflix that is delivered through its broadband network.⁴⁴ But pro-regulatory advocates, as well as Netflix, have argued that Comcast's arrangement is discriminatory or otherwise amounts to a violation of the spirit of the FCC net neutrality rules.⁴⁵

The U.S. Department of Justice is reported to be investigating cable companies, including their pricing practices and how they affect OVDs. Should DOJ pursue an interventionist course or if new regulation is taken up by the FCC, it means government would be interfering in the most dynamic segments of the video services market and could forestall future breakthrough developments that consumers would prefer.

Reforming the FCC's Annual Competition Reports

A particularly regrettable aspect of the FCC's regulatory policy, which has also been manifest in its annual competition reports for wireless services, is the lack of any serious analysis of cross-platform competition. Critical to the evolution of today's video market are the new capabilities it is rapidly developing for working seamlessly with new technological platforms, devices, software programs, applications, and pricing models.

Convergence and competition between different platform technologies is a generally recognized and increasingly significant theme in today's advanced telecommunications market. Relegating video, wireless, and other services into separate silos for regulatory purposes makes less and less sense in an interconnected digital economy where platforms overlap and integrate in increasingly sophisticated ways to deliver services to end-user consumers.

It remains to be seen whether the FCC's forthcoming Video Competition Report will factor cross-platform competition into its analysis. But there is also reason to be optimistic that the dynamic and convergent nature of today's broader digital marketplace will receive its due in a new kind of FCC report.

Congress is now considering the FCC Consolidated Reform Act, legislation that would combine and streamline eight different FCC reports into a unified and comprehensive annual report. The legislation would require the FCC to assess the state of competition taking place between providers of video, wireless, and other services. This approach would offer a better perspective of the competitive state of video services and even shed light on the unnecessary and outdated regulatory burdens that now saddle video services.

On May 30, the U.S. House of Representatives passed its version of the legislation (H.R. 3310) on a voice vote.⁴⁶ Perhaps the receptivity to these reforms in the House will lead to prompt passage of its Senate companion (S. 1780).⁴⁷

Conclusion

The FCC's Video Competition Report is far past its due date. But if the FCC's reports can be criticized for lack of timeliness, a similar criticism can be leveled at much of the FCC's legacy-era video regulation.

Whatever protections to competition the old regulations might be said to have provided in the early 1990s era of analog cable video, those layers of regulations are now costly drags on the market. Video services are already subject to FCC's **Retransmission Consent and Must-Carry regulations, Program Carriage regulations, Program Access regulations, Leased Access regulations, Cable Set-Top Box regulations,** and more. Stacking still more regulations on top of the existing rules, whether through the FCC's proposed **AllVid regulations** or an extension of its **network neutrality regulations** to vertically-integrated OVDs or to specialized services offering video, would only hamper the ability of MVPDs to deliver innovative new video service offerings.

Recent data already available to the public indicates the competitiveness of today's video market. Updated numbers regarding the competitive dynamics of the video market are welcome. But it should be a policy priority to relieve video services of burdensome regulations based on market share concerns from two decades ago. It should also be a policy priority to ensure that no new regulatory mandates inhibit growth in new kinds of video services. For the FCC, this should mean refusing to expand existing regulations, sunseting its general ban on exclusive contracts for satellite programming between MVPDs and vertically integrated satellite programmers, invoking its sunset provision to remove cable set-top box mandates, and declining to add new regulatory burdens on video devices or OVD services not mandated by statute. And for Congress it means revisiting the 1992 Act and its bottleneck assumptions and replacing it with a framework more congenial to free market principles and to the realities of today's convergent digital economy. A free market offers the optimal set of conditions for the next wave of breakthrough video services to be delivered to consumers.

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Further Readings

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³ See *id.* at 742.

⁴ See *id.* at 742 (Statement of Commissioner Jonathan S. Adelstein), *id.* at 745 (Statement of Commissioner Deborah Taylor Tate Approving in Part, Dissenting in Part); *id.* at 747 (Statement of Commissioner Robert M. McDowell Approving in Part, Dissenting in Part).

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⁷ *Id.*

⁸ *Id.*

⁹ See Nat'l Cable & Telecoms. Assoc. (NCTA), *In re* Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, Comments of NCTA, MB Docket No. 07-269 14 (June 8, 2011).

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- ²⁸ See *In re* Revision of the Commission's Program Access Rules; News Corporation and The DIRECTV Group, Inc., Transferors, and Liberty Media Corporation, Transferee, for Authority to Transfer Control Applications for Consent to the Assignment and/or Transfer of Control of Licenses; Adelphia Communications Corporation (and subsidiaries, debtors-in-possession), Assignors, to Time Warner Cable Inc. (subsidiaries), Assignees, et al., *Notice of Proposed Rulemaking*, MB Docket Nos. 12-68, 07-18, 05-192, at 10-11, ¶¶ 15-16 (2012)
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