

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

In the Matter of)	
)	
Annual Assessment of the Status of Competition)	MB Docket No. 15-158
in the Market for the Delivery Of)	
Video Programming)	

**COMMENTS OF
THE FREE STATE FOUNDATION***

I. Introduction and Summary

These comments are submitted in response to the Commission’s request for comments regarding Section 628(g)’s requirement that the Commission report annually on “the status of competition in the market for the delivery of video programming.” The focus of these comments is on that requirement’s purpose in keeping the Commission’s regulatory policies aligned with video marketplace realities. Today’s video market is a vibrant ecosystem of innovation and wellspring of valuable new product and service choices for consumers. But ongoing innovation and growth in video services is now threatened by legacy regulations as well as by Commission proposals for new regulations. Overregulation inevitably diminishes value to consumers by imposing added costs or restrictions on consumer choice.

Today’s video market indisputably is “effectively competitive.” So, the Commission surely should declare this in its forthcoming *Seventeenth Video Competition Report*. Yet in the face of

* These comments express the views of Randolph J. May, President of the Free State Foundation, and Seth L. Cooper, Senior Fellow. The views expressed do not necessarily represent the views of others associated with the Free State Foundation. The Free State Foundation is an independent, nonpartisan free market-oriented think tank.

the significant innovation, rivalry, and development of today's video marketplace, the Commission once again declined to declare the market "effectively competitive" in its *Sixteenth Video Competition Report* (2015). This avoidance seems calculated to prolong the already overextended life of legacy video regulation. By remaining mute about the market's competitiveness, the Commission also lends unmerited credence to calls for future regulatory intervention. Enforcing regulations premised on supposed video market deficiencies while ignoring the effectively competitive state of the market results in a policy mismatch harmful to innovation and investment and, therefore, to consumers.

In its recent *Effective Competition Order* (2015), the Commission examined nationwide and local video market competitive conditions and adopted a baseline presumption that local multi-channel video programming (MVPD) markets are effectively competitive. The Commission's next *Video Competition Report* should build on that order. The next report should not only acknowledge that the nationwide market for the delivery of video programming is effectively competitive, but its review of video competition should lead the Commission to remove old analog-era regulations or at least reorient them to a presumptively deregulatory posture to better promote competition and consumer welfare in this digital era.

This imperative of matching video regulatory policy to video market reality is bolstered by critical First Amendment dictates. Commission acknowledgment that the MVPD market is effectively competitive conceptually undermines the rationale for a broad swath of early 1990s MVPD regulations that restrict free speech. Must-carry, must-buy, program carriage, leased access, and other legacy regulations tell video service providers what they must say and through whom they must say it. Such rules override their editorial decisions with government mandates.

Given the presence of effective competition among MVPDs, OVDs, as well as wireless options, regulations restricting free speech can no longer be justified. And given the absence of

identifiable market power concerns or perceived distributional bottlenecks, First Amendment concerns should spur Congress to remove outdated regulatory burdens on speech in light of changed marketplace conditions. Free speech concerns also should prompt the Commission to eliminate regulations where it has the power to do so. The Commission should readjust regulations in a deregulatory direction where Congressional mandates remain in place. For Congress and the Commission, taking the First Amendment seriously means limiting government intervention in the video market to instances where intervention serves a compelling government interest while employing the least restrictive means.

In those instances where the Commission lacks the power to repeal legacy rules absent Congressional legislation, the Commission can still exercise its discretionary authority to reorient legacy rules to today's competitive market conditions. Following the approach of its *Effective Competition Order*, the Commission should employ deregulatory presumptions in its implementation of legacy rules in order to provide swifter and surer relief from burdensome regulations that no longer make sense. A sound basis exists for adopting deregulatory evidentiary presumptions regarding video market competition on a broad scale.

The Commission should also lay the groundwork for sunseting all Section 629 regulations, as the video market approaches being "fully competitive." Given the variety of choice in services and devices providing consumers access to IP-based and Internet-accessible video programming, the video device market is no longer an area where the FCC needs to be so intrusively involved. The availability of wireless and online video distributor ("OVD") bolsters this conclusion.

Indeed, explosive growth and high demand for OVD services epitomize the convergence of differing technology platforms on IP-based services. Cable operators have experienced ongoing market share decline simultaneous with DBS and telco MVPD competition, with growing evidence of consumers migrating from MVPD services to OVD services. News reports indicate

there may now 100 million or more OVD subscriptions – approximately the same number as MVPD subscriptions. It is therefore time the Commission finally begins taking OVD services seriously as a substitute for MVPD services. In addition to survey data regarding consumers who have dropped MVPD services in favor of OVD services, indicators of OVDs being close substitutes include growing numbers of OVD service providers and the increasing amount of content available through Internet streaming, the growing number of overall subscribers to OVDs, the stronger preferences of younger consumers for OVD services, and the investment by OVDs in original video content.

A video policy that truly aligns with today’s market reality will recognize the effectively competitive state of the market, respect First Amendment free speech requirements, eliminate unnecessary and outdated regulations, or at least readjust them in a deregulatory direction, and take seriously innovative new services, such as wireless and online video, as real competitors in the market.

II. The Video Market Is Effectively Competitive

In its *Effective Competition Order* (2015), the Commission readjusted some of its old cable regulations “for the first time in over 20 years, to reflect the current MVPD marketplace, reduce the regulatory burdens on all cable operators, especially cable operators, especially small operators, and more efficiently allocate the Commission’s resources.”¹ The Commission reversed the pro-regulatory presumption that local cable markets can be rate regulated for lack of effective competition. It shifted to a deregulatory presumption.

The *Order*’s modest regulatory relief for local cable services was a long time coming. Considering the competition that has existed in the video marketplace for many years, the

¹ Amendment to the Commission’s Rules Concerning Effective Competition, Report and Order (“*Effective Competition Order*”), MB Docket No. 15-53 (rel. June 3, 2015).

Commission could have – and should have – taken this deregulatory step long ago. But it is a welcome example of outdated FCC policy being readjusted to existing competitive market conditions. Regulations should reflect real-life conditions in competitive markets, regardless of the technology platform. And regulatory policy for markets where there is effective competition should be consistent, except where unique and compelling circumstances suggest otherwise. The Commission should build on its *Effective Competition Order* by seeking other ways to update its rules to reflect the current MVPD marketplace.

The *Order*'s assessment of the current MVPD marketplace was based on data summarized in the *Sixteenth Video Competition Report* (2015).² Data contained in the *Sixteenth Report*, as well as more recent developments in the market, evidence the video market's dynamism. There is ample publically available evidence for the Commission to conclude that today's video market is effectively competitive.

MVPD market share contained in the *Sixteenth Report* indicates “combined shares of all cable MVPDs accounted for approximately 53.9 percent of MVPD subscribers at the end of 2013, down from 55.8 percent at the end of 2012.”³ Also, “combined shares of the two DBS MVPDs accounted for approximately 33.9 percent of MVPD subscribers at the end of 2013, up from 33.8 percent at the end of 2012.”⁴ And “all telco MVPDs accounted for approximately 11.2 percent of MVPD subscribers at the end of 2013, up from 9.8 percent at the end of 2012.”⁵ As the Commission has observed, “on a national scale DBS alone has close to double the percentage of subscribers needed for competing provider effective competition.”⁶

² Annual Assessment for the Status of Competition in the Market for the Delivery of Video Programming, *Sixteenth Report*, MB Docket No. 14-16 (2015) (“*Sixteenth Report*”).

³ *Id.* at 10, ¶ 25.

⁴ *Id.* at 11, ¶ 26.

⁵ *Id.* at 11, ¶ 27.

⁶ Amendment to the Commission's Rules Concerning Effective Competition, Notice of Proposed Rulemaking, MB Docket No. 15-53, at 6, ¶ 6 (March 16, 2015).

Market entry by AT&T's U-Verse, Verizon's FiOS, and CenturyLink's PrismTV has further enhanced competitive choice for consumers. Indeed, with the recent AT&T/DirecTV merger, the largest nationwide provider of video services is no longer a cable operator.

Next-generation wireless network speed and capacity improvements make mobile an increasingly viable competitive alternative – indeed, in many instances a potential substitute for – wireline and DBS. Average LTE speeds range between 30 and 40 Mbps, enabling a broad array of video viewing options. Mobile digital media consumption through apps and mobile web browsing has already surpassed desktop-based digital media consumption, 60% to 40%. Future developments in next-generation technology will enable continued growth, with increasing choices and sources of value for consumers.

The online video distributor (“OVD”) market segment has been a powerful disruptor and growth engine. Subscription-based OVDs such as Netflix, HuluPlus, and Amazon Prime – as well as other over-the-top (OTT) Internet-based offerings – enable consumers access to video content through set-top boxes, video game consoles, smart TVs, desktop computers, tablets, and smartphones. The *Sixteenth Report* cited an estimate that, “as of 2013, more than 53 million U.S. households watched online programming with at least one Internet-connected device, including computers, game consoles, streaming media players, television sets, and Blu-ray players, with an average of 4.8 such devices per online viewing household.”⁷

Data cited in the *Sixteenth Report* indicated Netflix had 31.7 million subscribers to its streaming service at the end of 2013.⁸ Media outlets report that Netflix now has more than 65 million subscribers.⁹ During the first quarter of 2014, HuluPlus had more than six million

⁷ *Sixteenth Report*, at 142 ¶ 299 (internal cite omitted).

⁸ *Sixteenth Report*, at 147, ¶ 308.

⁹ Tenzin Pema, “Netflix Now Boasts More Than 65 Million Subscribers,” *Reuters* (August 15, 2015), at: http://www.huffingtonpost.com/2015/07/16/netflix-subscribers_n_7808782.html

subscribers.¹⁰ This spring, it was reported that HuluPlus had closer to nine million subscribers.¹¹ The *Sixteenth Report* cited estimates of Amazon Prime subscribership ranging anywhere from 10 million in 2013 to as much as 25 million for 2014.¹² Earlier this year, it was reported there are perhaps 40 million or more Amazon Prime subscribers.¹³ Thus, OVD subscriptions total 100 million or more – roughly equal to the MVPD subscriptions reported at the end of 2013.¹⁴

The Commission has observed an important indicator of OVDs’ growing competitiveness with MVPD services: OVD investment in original video content.¹⁵ Netflix, Hulu Plus, and Amazon Prime have all added original content. The *Sixteenth Report* also cited surveys and estimates regarding OVD substitution for MVPD services:

- [E]ight percent of U.S. households it surveyed reported that they had eliminated their MVPD service in the third quarter of 2013, compared with four percent in the first quarter of 2013;¹⁶
- 8.0 percent of respondents to a fourth quarter 2013 survey reported dropping premium cable networks, and 7.6 percent reported reducing the level of their MVPD service;¹⁷
- [A]s of 2013, 15.3 percent of adult broadband and MVPD subscribers it surveyed said they were likely to cancel their MVPD service, compared with 15.1 percent in 2012;¹⁸
- [A]mong pay TV households that kept their service, 15 percent decreased their level of service, with 69 percent of these cutting back on the number of program tiers purchased.¹⁹

The dynamism of what today’s video marketplace offers consumers is also reflected in the increasingly wide range of device options for access video content. IP-based HD-capable

¹⁰ *Sixteenth Report*, at 148, ¶ 309.

¹¹ Joan E. Solsman, “Hulu closes in on 9 million paid subscribers,” *c/net* (April 29, 2015), at: [http://www.cnet.com/news/hulu-closes-in-on-9-million-paid-subscribers/!](http://www.cnet.com/news/hulu-closes-in-on-9-million-paid-subscribers/)

¹² *Sixteenth Report*, at 148, ¶ 309.

¹³ Patrick Seitz, “Amazon Prime now tops Netflix in U.S. subscribers,” *Investors.com* (January 27, 2015), at: <http://news.investors.com/technology-click/012715-736533-amazon-prime-has-more-subscribers-than-netflix.htm>

¹⁴ See *Sixteenth Report*, at 10, ¶ 39.

¹⁵ *Id.* at 109-110, ¶¶ 232-233; *id.* at 152, ¶ 316.

¹⁶ *Id.* at 144, ¶ 302.

¹⁷ *Id.* at 144, ¶ 303.

¹⁸ *Id.* at 144, ¶ 303.

¹⁹ *Id.* at 144, ¶ 303.

MVPD provided set-top boxes, multi-room DVR and home networking solutions, cloud-based user interfaces, mobile applications, portable media players, gaming consoles, Internet-connected smartphones and table computers, and home monitoring systems are among features available to consumers. And consumers can choose to lease a set-top box from their cable operator or buy devices at retail that enable them to watch cable, broadcast, and online programming.

Streaming apps and mobile platforms like Apple's iOS and Google's Android provide many consumers access to cable programming offered by Comcast, Time Warner Cable, Cox, Charter, Cablevision, and Bright House. Comcast and Time Warner Cable programming can also be accessed by Microsoft's Xbox 360, and Time Warner Cable provides its subscribers access to video-on-demand services through additional devices like Roku and Samsung Smart TV's. DirecTV, DISH, AT&T, and Verizon have also made their content available through iOS and Android mobile platforms and devices. Additionally, DirecTV offers its programming through DirecTV Ready TVs and Samsung TVs. And both DISH and DirecTV offer programming through smart TVs that do not require a set-top box or other receiver. OVDs also make content available on smartphones, tablets, and laptops as well as new connected devices like Roku, Apple TV, and game consoles like Xbox One, Sony Playstation 4, and Nintendo Wii U.

The Commission should recognize this abundance of consumer choice and healthy rivalry in the video marketplace by finally acknowledging its effectively competitive status in the forthcoming *Seventeenth Video Competition Report*.

III. Market Competition and First Amendment Concerns Should Prompt Reduction of Legacy Video Restrictions on Speech

A clear disconnect exists between the effectively competitive state of the current video market and the outdated legacy video regulations that are still in place. Despite the dramatic innovative and competitive change in the marketplace since the early 1990s, the Commission

continues to apply antiquated, analog-era regulations to a thriving convergent, IP-based digital video market. Such overregulation is unjustifiable and can harm consumer welfare through restrictions or compliance costs on future innovation and competitive choices.

This policy imperative of matching video policy to video market reality is bolstered by First Amendment considerations. Commission acknowledgment in its *Effective Competition Order* that the MVPD market is effectively competitive conceptually undermines the rationale for a broad swath of early 1990s MVPD regulations that restrict free speech. U.S. Supreme Court and circuit court opinions acknowledge the First Amendment rights of MVPDs in editorial decisions regarding programming content.²⁰ According to judicial precedents, many regulatory restrictions on MVPDs' First Amendment rights – including must-carry/retransmission consent, must-buy basic tier requirements, program carriage, and leased access – were deemed permissible because of the assumed existence of cable monopoly conditions.²¹ These kinds of regulations effectively tell video service providers what they must say by overriding their editorial decisions with government mandates.

For instance, decades-old must-carry regulations require MVPDs to carry broadcast TV content not of their own choosing. This curtails MVPDs' editorial discretion in choosing channel lineups and arranging channel tiers. Must-buy provisions that require MVPDs to carry local broadcast stations on its basic tier of programming that it must provide to all subscribers before offering premium tiers also curtails MVPD free speech rights in selecting content. Program carriage regulations designed to protect video programmers unaffiliated with MVPDs from “discrimination” substitute bureaucratic judgment about program channel selection and lineup placement for MVPDs' judgment. And “leased access” regulations, which require MVPDs to

²⁰ See, e.g., *Turner Broadcasting System, Inc. v. FCC*, 512 U.S. 622 (1994); *Time Warner Cable v. FCC*, 667 F.3d 630 (5th Cir. 2012).

²¹ See, e.g., *Turner*, 512 U.S. 622.

make channel capacity available to third parties at government-set rates, deprive MVPDs of editorial control over any video programming on the leased channels.

Given the presence of effective competition between MVPDs, OVDs, as well as wireless options, such intrusive restrictions on free speech can no longer be justified. Given the absence of identifiable market power concerns and perceivable distributional bottlenecks, First Amendment concerns should spur Congress to remove outdated regulatory burdens on speech in light of changed marketplace conditions. And free speech concerns should prompt the Commission to eliminate regulations where it has the power to do so and to readjust regulations into a more deregulatory setting where Congressional mandates remain in place.

For Congress and the Commission, taking the First Amendment seriously as a policymaking guide means limiting government intervention in the video market to instances where intervention serves a compelling government interest while limiting burdens on protected speech rights. Regulation of speech media in today's dynamic market, where compelling need is demonstrated, should use the least restrictive means. And in light of continuing market change, regulatory policy should be frequently reviewed to ensure continued compliance with free speech principles. Equal speech protections should be accorded to all video services, regardless of the media or technology used, unless unique and compelling factors indicate otherwise.

The next wireless report should call Congress's attention to this disconnect between outdated video policy and today's market reality. In light of that disconnect, as well as First Amendment concerns, the Commission should use data and analysis in its next report as the foundation for further readjustment to match today's video market reality.

For example, the Commission's pending proposal to remove broadcast exclusivity rules in favor of allowing contractual relationships to govern matters between MVPDs and providers of

broadcast TV warrants serious consideration.²² The Commission took a similar approach in eliminating the decades-old sports blackout rule while acknowledging that in-place private contractual arrangements might still lead to some blackouts.²³ It should build on that precedent of eliminating legacy regulations that were adopted in a bygone era.

And following the approach of its *Effective Competition Order*, the Commission should employ deregulatory presumptions to provide swifter and surer relief from burdensome regulations that no longer make sense. The Commission has a sound basis for adopting such evidentiary presumptions regarding marketplace competitiveness on a broader scale. Until Congress repeals Commission should pursue this approach to those rules identified earlier that

A strong case also exists for finally eliminating set top box rules. When the Commission first implemented Section 629 in 1998, the Commission found that local markets for the delivery of video programming were still highly concentrated and permitted exercise of market power by incumbent cable systems.²⁴ But Section 629 specifically provides a sunset provision which allows that the regulations adopted “shall cease to apply when the Commission determines that: (1) the market for the multichannel video programming distributors is fully competitive; (2) the market for converter boxes, and interactive communications equipment, used in conjunction with that service is fully competitive; and (3) elimination of the regulations would promote competition and the public interest.”²⁵

Given the great variety of choice in services and devices providing consumers access to IP-based and Internet-accessible video programming, it is clear that the video device market is no longer an area where the FCC needs to be so intrusively involved. Data cited earlier regarding

²² See Amendment of the Commission’s Rules Related to Retransmission Consent, Report and Order and Further Notice of Proposed Rulemaking, MB Docket No. 10-71 (March 31, 2014).

²³ Sports Blackout Rules, Report and Order, MB Docket No. 12-3 (Sept. 30, 2014).

²⁴ 47 U.S.C. § 549 (1996), as amended,

²⁵ 47 U.S.C. § 549(e).

OVD substitution bolsters this conclusion. The competitive structure of today’s video marketplace and corresponding consumer behavior trends warrant dismantling of all analog-era regulations premised on anti-competitive, monopolistic conditions that no longer exist. There is ample evidentiary basis for the Commission to declare the above markets “fully competitive” and to sunset its Section 629 regulations immediately or on an established timetable.

At the very least, the Commission could use the facts and analysis of its next video competition report to lay the groundwork for a near-future Section 629 sunset upon establishing a workable definition of “fully competitive” using a market-based standard of analysis that relies on antitrust insights. A proceeding could be commenced whereby the Commission sets an interpretive standard of what constitutes a “fully competitive” market and subsequently applies it to the current video market. For instance, a “fully competitive” market could be deemed to exist where no evidence of market power exists that poses a threat of anti-competitive conduct or consumer harm. Absent any such findings, Section 629 regulations could be sunset.

IV. The Commission Should Consider OVD Services as Substitutes for MVPD Services

It is also time the Commission finally begin taking OVD services seriously as a substitute for MVPD services. The *AT&T/DirectTV Order* (2015) appears to be the Commission’s most conclusive policy statement on the issue of OVD substitution. There it insisted: “[F]or most consumers today, OVD services are not substitutes for MVPD services. Rather... OVDs typically offer consumers choices that may either complement their MVPD services or compete with some portion of the services MVPDs offer, such as VOD.”²⁶ The *AT&T/DirectTV Order* also stated: “[W]e do not have evidence on the record that any OVD would be, in the near term, a disciplining force if the combined entity were to increase price or decrease quality.” However:

²⁶ Applications of AT&T Inc. and DIRECTV For Consent to Assign Transfer Control of Licenses and Authorizations, Memorandum Report and Order “*AT&T/DirectTV Order*”, MB Docket No. 14-90, at 30, ¶ 68 (rel. July 28, 2015).

“[W]e acknowledge that OVDs have the potential to become substitutes for MVPD services with a market presence that is sufficient to counter effectively an increase in price or decrease in quality by the combined entity.”²⁷

Surely, the record in the AT&T/DirecTV merger proceeding does not exhaust publicly available evidence of OVD substitution. The survey data regarding consumers who have dropped MVPD services in favor of OVD services already provide strong indicators of OVDs as close substitutes. Other indicators include the growing number of OVD services and content available through Internet streaming, the growing number of overall subscribers to OVDs, the stronger preferences of younger consumers for OVD services, and the investment by OVDs in original video content. Further, the *Sixteenth Report* showed an actual overall decrease in MVPD subscriptions over the prior report period, while OVD subscriptions climbed. Recent news accounts indicate that investors take MVPD future steep subscriber losses very seriously.²⁸

The Commission’s dismissal of OVD substitution appears based on an unduly narrow conception of market competition. MVPD price data should certainly be considered in light of OVD competition. But price competition is by no means the only mode of competition. Improvements in quality and innovation also benefit consumers. MVPDs continue to offer service enhancements, including increasing numbers of mobility viewing choices, time-shifting options, and more channels, with Ultra-HD on the horizon. Any price analysis must factor in innovation and additional value offered by MVPDs – and it must be said that Commission analyses, historically, have been deficient in this regard. Moreover, even with enhanced value offered by MVPDs, today’s dynamic video market is susceptible to the “innovator’s dilemma” whereby value-conscious consumers opt for simpler and more cost-effective opportunities.

²⁷ *Id.* at 30, ¶ 68.

²⁸ *See, e.g.*, Thad Moore, “Cracks in the cable business send media stocks tumbling,” *Washington Post* (August 7, 2015), at: http://www.washingtonpost.com/business/economy/cracks-in-the-cable-business-send-media-stocks-tumbling/2015/08/07/bc0ceacc-3d38-11e5-8e98-115a3cf7d7ae_story.html.

Also, it is unreasonable to expect hypotheticals of OVDs potentially checking increases of MVPD prices to above-market levels or deliberate quality reductions to materialize for actual study. Existing competition among cable, DBS, and telco MVPD services likely would cause any MVPD engaging in such anticompetitive conduct to lose subscribers and market share to MVPD competitors offering services at a market price. Indeed, the only evidence likely ever to materialize regarding substitution is the same type of facts and trends that are recognizable today. And that evidence provides firm basis for regarding OVD services as a substitute product.

V. Conclusion

For the foregoing reasons, the Commission should act in accordance with the views expressed herein.

Respectfully submitted,

Randolph J. May
President

Seth L. Cooper
Senior Fellow

Free State Foundation
P.O. Box 60680
Potomac, MD 20859
301-984-8253

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