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

In the Matter of	)	
	)	
Amendment of the Commission's Rules Related to Retransmission Consent	)	MB Docket No. 10-71
	)	

COMMENTS OF

THE FREE STATE FOUNDATION*

These comments are submitted in response to the Commission's *Notice of Proposed Rulemaking* released March 3, 2011. The *Notice* seeks comment regarding proposed changes to the Commission's retransmission consent negotiation rules. At the outset, the Commission states that its "primary objective is to assess whether and how the Commission rules in this arena are ensuring that the market-based mechanisms Congress designed to govern retransmission consent negotiations are working effectively and, to the extent possible, minimize video programming service disruptions to consumers."[1] The primary purpose of these brief comments and the two attached appendices is to show that the current negotiation regime is not, in fact, a "market-based" one. As I explained in a Free State Foundation *Perspectives* paper last October, ""[d]espite any suggestions to the contrary, negotiations between broadcasters and cable

* These comments express the views of Randolph J. May, President of the Free State Foundation. The views expressed do not necessarily represent the views of others associated with the Free State Foundation. The Free State Foundation is a nonpartisan, Section 501(c)(3) free market-oriented think tank.

[1] NPRM, In the Matter of Amendment of the Commission's Rules Related to Retransmission Consent, MB Docket No. 10-71, March 3, 2011, at 2, para. 1.

operators over retransmission consent do not take place in a 'free market' context. There are significant government-imposed conditions and constraints…that alter the claimed free market context."[2]

In crucial respects, the Commission's current retransmission consent and must-carry regulations foster an unfree market in video programming. Consequently, the review of the Commission's rules should take into account the ways in which those rules rest on restrictive, protectionist premises that limit private bargaining and ultimately limit video programming outputs to the detriment of consumers.

A free market exists where private parties are at liberty to pursue commercial dealings and to bind themselves, by mutual consent, to negotiated terms and conditions. Restrictions on which parties may enter into such agreements or what terms and conditions may be included in such agreements are generally decided by the parties themselves. And parties enter into commercial dealings with the understanding that their contractual arrangements, including their bargained-for expectations, will be enforced by an impartial authority applying neutral laws.

Contrary to these market-based principles, the existing laws and regulations regarding video program retransmission include forced-access mandates. Under "must-carry" rules, video broadcasters are granted special rights against cable operators by which broadcasters may compel carriage of their program content on a basic tier channel. Direct broadcast satellite operators are also subject to certain must-carry mandates favoring video broadcasters.

When video broadcasters so choose, however, they may forego their must-carry rights and instead require that cable operators negotiate directly with them to obtain permission to retransmit their video programming. But, even in this context, there are regulatory restrictions

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[2] Randolph J. May, "Broadcast Retransmission Negotiations and Free Markets," *Perspectives from FSF Scholars*, Vol. 5, No. 24, October 18, 2010. This paper is appended hereto as Appendix A.

that inhibit their ability to bargain freely. The Commission's network non-duplication rules block cable operators from importing network programming from another affiliate of the same broadcast network as a designated local TV station, even if the local TV station is not carried by the cable system. And the Commission's syndicated exclusivity rules block cable operators from carrying syndicated programming broadcast by out-of-market broadcast TV stations when the same programs are broadcast by local TV stations. Whereas a free market approach would allow broadcast networks and their affiliates to factor possible cable operator retransmission of broadcast programming into network-affiliate agreements, the Commission's rules grant protections to broadcast networks and local stations by limiting the ability of cable operators to choose what broadcasters to bargain with and what programming to bargain for.

Review of existing rules with an eye toward making the video market more free market-oriented is particularly compelled by the dramatic changes that have occurred in the video market since adoption of the legacy regulations. Everyone knows that many of the present regulatory restrictions were based on presumptions about the video market as it existed years ago that are simply not pertinent to today's market — if they ever were. As the Commission acknowledges in its Notice, "[s]ince Congress enacted the retransmission consent regime in 1992, there have been significant changes in the video programming marketplace."[3]

In a FSF *Perspectives* paper entitled "The FCC and the Unfree Market for TV Rights," Bruce Owen, a member of the Free State Foundation's Board of Academic Advisors, surveyed the history of decades of government regulation of the video marketplace and the dramatic changes that have resulted in a competitive marketplace. This was his conclusion: "The lesson: By all means let a competitive market in TV programming operate free of regulatory

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[3] NPRM, MB Docket No. 10-71, at 2, para. 2. See also, Seth Cooper, "Video Competition Should Lead FCC to End Old Regulation, May 4, 2011, at http://freestatefoundation.blogspot.com/2011/05/video-competition-should-lead-fcc-to.html.

intervention. But first, create a truly free market by repealing artificial and unproductive legacy rights, such as must carry and retransmission consent, which are no longer needed – if ever they were – in today's competitive communications marketplace."[4]

As the Commission undertakes its review of the existing retransmission consent negotiation regime, it should understand that the current market is "unfree."

Respectfully submitted,

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May 27, 2011

[4] Bruce M. Owen, "The FCC and the Unfree Market for TV Program Rights," *Perspectives from FSF Scholars*, Vol. 6, No. 7, March 2, 2011. This paper is appended as Appendix B.

Appendix A

THE FREE STATE FOUNDATION

A Free Market Think Tank for Maryland......Because Ideas Matter

Perspectives from FSF Scholars
October 18, 2010
Vol. 5, No. 24

Broadcast Retransmission Negotiations and Free Markets

by

Randolph J. May*

In recent years, rising broadcast retransmission fees have been the source of increasing friction between broadcasters and multichannel video programming distributors (MVPDs) negotiating over rights to retransmit broadcast signals. Just witness this past weekend's loss of Fox TV's network television programs by Cablevision's subscribers in New York, Philadelphia, and the surrounding areas. Not surprisingly, in light of the increasing number of blackouts and threatened blackouts of network television programming by broadcasters, there is now an important debate emerging concerning whether the FCC should adopt a set of negotiation and dispute resolution rules to address "must-carry" and retransmission consent rights.

There is a fundamental issue, however, that needs to be addressed before considering whether, or what kind, of new rules should be adopted governing the negotiations between the broadcasters and the multichannel video distributors. This is the issue concerning whether, as the broadcasters often claim, the government ought to take a completely "hands off" policy towards the negotiations because they take place in a "free market" context, or whether, instead, there are conditions that exist that make the context of the bargaining a rather "un-free" market.

At the Free State Foundation, we aspire to play second-fiddle to no one in favoring unfettered bargaining between private parties in a true competitive, free market context.

Private bargaining, in which the parties know their own interests, and can contract freely to place a market value on their interests, benefits consumers more than a regime in which government substitutes its judgment for that of the private parties and handicaps the negotiations. But, at FSF, we know a free market when we see one. And under the existing legal and regulatory regime, retransmission consent negotiations simply don't take place in a free market setting.

Rather, as described below, the negotiations occur in the context of a federal law and regulation overlay that mixes elements of private bargaining with forced-access and protectionist elements. This creates artificial constraints that make the negotiations anything but a free market situation. Indeed, the statutory and regulatory constraints have the effect of conferring certain advantages that may work to the negotiating advantage of broadcasters and against the MVPDs.

Beginning with the Cable Act of 1992, Congress mandated that broadcasters may compel cable operators 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 cable providers. And Congress has mandated that the "must-carry" broadcaster, which has been granted its spectrum free of charge, gets to pick which particular cable channel must carry its content. (Since passage of the Satellite Home Viewing Improvement Act of 1999, Direct Broadcast Satellite providers are under many of the same must carry-type mandates as cable operators.)

Alternatively, broadcasters can elect to forego the "must-carry" option and instead negotiate directly with video distributors for retransmission of their broadcast signal. But cable providers are again restricted from freely negotiating in the bargaining process. The FCC's network non-duplication regulations allow local stations to block cable systems from importing network programming from another affiliate of the same broadcast network - even if the out-of-market broadcast affiliate and the cable network otherwise could reach a negotiated agreement. Similarly, syndicated exclusivity regulations allow local stations providing syndicated broadcast programming to prevent cable systems from carrying the same programs broadcast by out-of-market broadcast stations.

In passing the 1992 Act, Congress was motivated by what was then perceived to be a bottleneck for video distribution. The congressional restrictions sought to "protect" broadcasters in local broadcast markets from competing content offered by cable companies or from retransmission of out-of-market broadcasting content. "Must carry" mandates, in particular, were enacted out of a professed concern that, absent regulatory intervention, cable's perceived dominance over multichannel video distribution could result in local broadcasting being "blacked out."

Put aside for now any disputes concerning whether, even in 1992, cable had the stranglehold over multichannel video distribution upon which the Cable Act was premised. No matter. There can be no dispute that the video marketplace of 2010 is vastly more competitive than it was in 1992. With two major DBS providers offering nationwide service, and firms formerly known as "telephone companies" rolling out their own multichannel video services, cable operators today face serious competition. And consumers are now able in many instances to choose between two, three, or even four video service providers. These market developments have rendered whatever worries that existed in 1992 all but obsolete. And this is even more so with broadband Internet and wireless services now offering consumers even more avenues for receiving video content – of which they are very rapidly availing themselves.

Over the last few years, however, broadcasters have demanded that MVPDs pay larger retransmission fees based on the number of video subscribers receiving broadcasting content. MVPDs paid approximately $738 million to broadcasters in retransmission fees in 2009, with the number expected to increase to as much as $1.6 billion by 2015. Also, with increasing frequency, broadcasters are threatening to withhold retransmission consent prior to major viewing events, such as the Super Bowl. And we are now seeing that these threats are real. When negotiations over retransmission consent have broken down, MVPD consumers have, in fact, experienced blackouts of major events. For instance, earlier this year, an ABC station owned by Disney withheld its programming from Cablevision in New York and briefly interrupted the Academy Awards show. And, we have this past weekend's episode of a blackout in connection with the Fox/Cablevision dispute.

Contending that the 1992 Cable Act and FCC regulations no longer reflect the realities and incentives of today's video marketplace, a broad array of MVPDs – cable operators, satellite providers, telephone companies; note they all compete against each other - have petitioned the FCC to adopt one or more dispute resolution mechanisms. The petition suggests, for instance, mandatory arbitration or similar proceedings when negotiations break down. It also suggests that the FCC adopt mandatory interim carriage on the same terms contained in prior agreements when negotiations break down. Other rules are suggested both in the petition and in public comments submitted to the FCC.

The point here, however, is not to debate the wisdom of the proposed rules. I am sure there are pros and cons that ought to be carefully weighed regarding the proposals.

Rather the point here is much more fundamental: Despite any suggestions to the contrary, negotiations between broadcasters and cable operators over retransmission consent do not take place in a "free market" context. There are significant government-imposed conditions and constraints, such as those discussed above, that alter the claimed free market context.

It is necessary to understand this fundamental point as a predicate to consideration of the changes suggested to the retransmission consent negotiation process.

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Appendix B

THE FREE STATE FOUNDATION

A Free Market Think Tank for Maryland......Because Ideas Matter

Perspectives from FSF Scholars
March 2, 2011
Vol. 6, No. 7

The FCC and the Unfree Market for TV Program Rights

by

Bruce M. Owen*

Should the Federal Communications Commission step in to prevent temporary programming blackouts caused by bargaining impasses between MVPDs and broadcasters? Blackouts are black eyes for the industry and for the FCC because they garner heavy negative media coverage. But some say that negotiations between the broadcaster "must carry" and "retransmission consent" rights holders on the one hand, and cable and satellite companies on the other hand, are part of the competitive free market process, with which the Commission should not meddle. The problem, of course, is that the TV program market is not free and competitive, partly because of rules promulgated by Congress or by the FCC itself. These rights yield no productive value for the economy, but merely transfer profits from one industry group to another in a way that is costly to consumers. The rules create rather than correct a market failure.

The media business is complex. Media companies buy or produce "content" such as TV and radio programs, comic strips, or news coverage. The media sell or give away content to listeners, viewers and readers. Media companies also deliver readers and viewers to advertisers. Competition is rampant, not only for audiences and advertisers, but for content.

Changing technology presents additional challenges. In the last century many new technologies came along – and in some cases, went away. New media technologies included AM and FM radio, digital radio, many forms of recorded music and video, television, color television, cable television, satellite television, digital television, and the Internet. The printing press has survived this onslaught but is now much diminished in importance as a medium of communication. But all this churning bespeaks a market for content that is robustly competitive – except where it isn't. And where it isn't, it's largely on account of regulatory interventions that no longer make much sense, even if they once did make sense.

The problem is that industries faced with acute pressure from competition and technological changes often seek assistance from the government. By its nature, the demand for protection originates from the established firms who aim to stop or at least attenuate inroads by new entrants and new technologies. New entrants and technologies threaten established firms precisely because they offer more or better services and lower prices to consumers. Government protection for the established suppliers often works by depriving consumers of such benefits. Protection for established firms is therefore likely to be harmful to the public, keeping prices high and slowing the availability of new products and services.

Media businesses in particular have made frequent use of government protection. Our elected representatives enjoy photo ops with showbiz celebrities, and they greatly value face time on the local TV evening news. TV broadcasters have one of the most powerful lobbies in Washington. The FCC does what Congress tells it to do, and it likes to feel that it is useful to the industries it regulates. What could be more useful than maintaining a safe and stable environment for the media businesses that matter to Congress?

Many FCC rules and regulations arise from these impulses to manage competition, though they are often papered over with attempts at public interest rhetoric. Nothing could better illustrate FCC attempts to manage the market than the weird history of TV broadcasts carried on cable television, satellite and other broadband services.

Decades ago, in the 1950s, cable systems simply offered better reception for local TV signals. That was fine with the TV stations, and therefore fine with the FCC, which concluded it had no jurisdiction anyway. Then in the 1960s cable systems started to carry TV stations from distant cities. This was definitely *not* fine with local TV stations, which were losing part of their audience. Suddenly the FCC decided it *did* have jurisdiction, and it ordered cable systems to stop importing distant stations. Clearly this FCC action harmed TV viewers, who were denied a wider choice of programs. In effect, the FCC created a new right, the right to be free of competition from out-of-town stations, and awarded that right to all local stations. Economically, this was equivalent to taxing cable operators and subscribers and using the proceeds of the tax to send out economic security payments to local TV stations.

About a decade later, in the late 1970s, because of low transmission prices resulting from the introduction of domestic communication satellites, there was an explosion of new cable networks such as HBO and CNN. This greatly diminished the competitive significance of distant broadcast signals. Lacking continued broadcaster interest in continued protection, the FCC deregulated distant signal carriage as a sop to reformers. Then, in the 1980s, as dozens and then hundreds of new cable networks became available, cable systems themselves began to lose interest in carrying the less popular (non-network-affiliated-UHF) local TV stations. In a free market, weaker local TV stations probably would have paid cable systems for carriage. But the FCC, of course, required cable systems to carry all local stations without charge.

The FCC "must carry" rules made cable somewhat less profitable than it would have been, slowing the growth of the cable industry, and denying choices to consumers in unwired areas. Again, the FCC created a new right, which it awarded to TV stations, to be free of the burden of paying for local cable carriage. Consumers and cable operators once again essentially wrote a check to the FCC, which the FCC passed on to the TV stations. The IRS got nothing out of the transfer, and the public got less than nothing.

The early 1990s brought growing awareness that the future profitability of the broadcast networks was clouded by competition from cable networks, not to mention new broadcast networks such as Fox. CBS led a lobbying campaign to introduce another new property right called "retransmission consent." At that point cable systems were already paying for programs on TV stations they were obliged or permitted to carry under the FCC's many rules. Since 1976 cable operators have enjoyed by law a compulsory license from the owners of the actual TV programs, for which they pay a small percent of their gross receipts into a central pool redistributed to program producers by the Register of Copyrights.

After passage of the 1992 Cable Act, the popular network-affiliated TV stations could demand to be paid a "retransmission consent" fee by cable operators. Except for local news shows and the like, broadcasters generally don't own copyrights in their programming. (TV stations merely acquire licenses to broadcast network or syndicated programs in local markets, not the right to license those programs to other distributors.) "Retransmission" in effect created yet another new property right, and assigned ownership of the right to TV network affiliates, the largest and most important of which are owned by the broadcast networks themselves. Non-network broadcast stations continue to benefit from must-carry.

Unlike program producers and networks, TV stations do nothing to "earn" this right, and the benefits to them are not rewards for innovation or production of valuable services. The economic value of a retransmission right comes solely from the ability of its owner to extract cash (or carriage) from cable systems and other multi-channel video program distributors (MVPDs). In fact, now that nearly everyone gets all TV signals by cable or satellite or Internet, broadcast stations are largely useless relics of a bygone technology, and the spectrum that is still reserved for their use has far better and more valuable uses.

In practice, the broadcast networks have mostly used their retransmission consent rights to induce cable operators and other MVPDs to carry new cable networks owned by the broadcasters. When a new cable network enters the business, with a relatively low audience share, it must pay cable operators for carriage in order to achieve nationwide coverage. Once that is achieved, the most popular and successful cable networks start charging cable operators for their programming. The retransmission consent right makes it possible for broadcaster-owned cable networks to avoid paying for carriage during their startup period, and it permits them to reach economic viability much earlier and more cheaply than otherwise. Once again, cable operators and subscribers in effect are writing checks to the FCC, which passes the proceeds on to the wealthiest broadcasters.

The key to this system of taxes and subsidies is the ability of the FCC, with congressional sanction, to create new property rights and to decide who should own those rights. These are powerful tools that *could* be used for worthy ends, such as correcting or reducing the adverse effects of various market failures. But they can also be used to disadvantage consumers and one or another category of competitor in order to benefit a category more favored by the regulatory agency. Such transfers are nurtured and energized by political influence and the collective action difficulties faced by consumers with relatively small and diffuse interests in any given regulatory issue. Broadcasters, as the only group with the ability to control TV access by politicians to large fractions of local voters, have enormous power in this game. They seldom lose.

It is often difficult to predict exactly what will happen if a regulatory intervention, much less a whole set of interventions, were to be repealed. In this case, however, the prediction is very easy to make. Absent regulatory intervention there would be no TV broadcast industry today, and cable operators and other MPVPs would pay nothing to broadcasters. The MPVDs would acquire program rights directly from the program content owners. Without broadcasters to tax MVPDs and viewers there would be more programming and lower program prices. With less certainty, one can say that cable, satellite and telephone broadband providers would be facing additional competition from wireless broadband suppliers using the spectrum currently devoted to wasteful TV broadcasts. In such a world there would be no need for most FCC regulation, including "net neutrality" or content regulation.

The lesson: By all means let a competitive market in TV programming operate free of regulatory intervention. But first, create a truly free market by repealing artificial and unproductive legacy rights, such as must carry and retransmission consent, which are no longer needed – if ever they were – in today's competitive communications marketplace.

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