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The Case for Program Carriage Reform

by

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The Federal Communications Commission's Section 616 program carriage regulations restrict cable operators' ability to negotiate the terms and prices with independent video programmers that want their programming carried on cable networks. In its May 28 *Comcast v. FCC* decision, the D.C. Circuit rejected a recent Commission assertion of even more regulatory power over program carriage decisions.

The outcome in *Comcast v. FCC* centered on the clear lack of evidence to support the Commission's 2012 *Tennis Channel Order*. The FCC granted a complaint filed by the Tennis Channel alleging unlawful discrimination by Comcast. In the middle of a contract term, the Tennis Channel demanded that Comcast move it to a broader distribution tier on Comcast's cable systems. The D.C. Circuit's rejection of far-fetched FCC arguments for sustaining its regulatory intervention in favor of the Tennis Channel could serve as precedent for staving off future regulatory overreach.

Moreover, a very important concurring opinion by Judge Brett Kavanaugh sheds critical light on how the FCC has grossly misinterpreted the program carriage statute to protect competitors rather than consumers. And Judge Kavanaugh highlighted the profound First Amendment problems raised by the FCC's restrictions on the editorial discretion of cable operators regarding programming decisions in a marketplace characterized by competition among various video platforms.

Comcast v. FCC should wake Congress and the FCC up to the reality that legacy cable regulations have long outlived the early 1990s market assumptions once said to rationalize them. The FCC now has opportunity to rethink its overly aggressive regulatory approach to program carriage. For several years, the FCC has sought ways to expand its regulatory control over video services. But now, with the D.C. Circuit's decision in hand, it is time for the FCC to consider a deregulatory, free market approach that takes into account the video choices that cable, DBS, telco entrants, over-the-air, mobile, and various Internet-based distributors now offer consumers.

Judge Kavanaugh's consumer welfare-focused interpretation of Section 616 and accompanying analysis of program carriage regulations is highly persuasive. And it may presage future federal court rulings regarding the continued lawfulness of early 1990s cable regulations, and, in particular, the newly-expanded program carriage regulations. In fact, a challenge to the FCC's program carriage "stand still" rule is now pending before the U.S. Court of Appeals for the Second Circuit.

But the FCC ought not wait for further court rulings. Now is the time for the FCC to reconsider its harmful competitor-welfare focused approach to program carriage regulation. After *Comcast v. FCC*, at a minimum, the Commission should reframe its regulations so that they are less intrusive and so that they interfere less with cable operators' editorial discretion – in other words, so that they comport with the consumer welfare and market power standard that the statute calls for and which the First Amendment demands.

Section 616: Regulating Competition Under Uncompetitive Assumptions

In the early 1990s, consumers typically had only one choice for paid video subscription services. The 1992 Cable Act was therefore premised on a perceived cable bottleneck in video distribution. Section 616 of the 1992 Act requires the FCC to adopt program carriage regulations governing the conduct of vertically integrated video programmers – that is, cable operators providing retail service to customers that also have an attributable interest in the video content they make available. Mirroring the statute's language, FCC program carriage regulations prohibit multichannel video programming distributors' (MVPD) conduct, the effect of which is to "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."

Significantly, neither Section 616 nor the FCC's program carriage regime have been amended or updated to reflect today's video marketplace realities. These marketplace changes have been the subject of previous *FSF Perspectives* essays and blog posts. Suffice it for now to consider a few numbers from the FCC's *14th Video Competition Report*.

As of 2010, 32.8% of households had access to four MVPDs and 65.7% of households had access to three MVPDs. That is, 98.5% of all households had access to *at least* three MVPDs. The combined market shares of the five major cable operators dropped to 60% of the video subscriber market, with direct broadcast satellite (DBS) providers possessing 34% and recent "telephone" MVPD entrants serving 7% of the market. Meanwhile, consumers have access to over-the-air broadcast TV, and online video distribution has shown tremendous growth, in both subscription models like Netflix, Amazon Prime, or Hulu, as well as stand-alone purchase models such as iTunes.

There are many facets to the current video landscape that these numbers leave out. But by themselves these developments demolish any monopolistic grounding for continued enforcement of legacy cable regulation. Indeed, TiVo CEO Tom Rogers recently stated at a Sanford Bernstein investor conference that the amount of choice consumers have in video content is "overwhelming and chaotic." Still, the FCC's program carriage regime continues as if nothing has changed. If anything, it is now expanding.

The Tennis Channel Complaint

The saga surrounding the Tennis Channel's program carriage complaint is a prime example of the recent expansion of FCC regulatory intrusion despite the reality of increasing video competition.

In the middle of a negotiated contract term, Tennis Channel requested that Comcast give it broader distribution by moving it to the same programming tier on which two Comcast-affiliated networks – the Golf Channel and Versus (now called the NBC Sports Network) – were located. Comcast declined to do so and Tennis Channel filed a program carriage complaint.

In 2011, an FCC Administrative Law Judge (ALJ) ruled that Comcast's decisions regarding which programming tiers and which channel numbers the Tennis Channel should be assigned constituted unfair discrimination. In so ruling, the ALJ compared the programming of the Tennis Channel with that of the Golf Channel and Versus. The comparison considered programming genres, target audiences, advertisers, and ratings. The ALJ deemed the Tennis Channel "similarly situated" to the other channels. It ordered Comcast to carry the Tennis Channel "at the same level of distribution that it carries the Golf Channel and Versus," and "to provide the Tennis Channel with equitable treatment (*vis-à-vis* the Golf Channel and Versus) as to Channel placement." The ALJ said Comcast could comply with the ruling by reducing distribution of the Golf Channel and Versus to the same level as the Tennis Channel.

In its 2012 *Tennis Channel Order*, the FCC concluded that record evidence supported the ALJ's finding of unfair discrimination. It therefore upheld the ALJ's program carriage remedy, except for the portion involving channel placement. The FCC also concluded that the ALJ's "similarly situated" discrimination analysis and its equal carriage remedy were consistent with the First Amendment.

Comcast appealed the FCC's ruling to the U.S. Court of Appeals for the D.C. Circuit. And on May 28, the D.C. Circuit ruled unanimously against the FCC.

D.C. Circuit: FCC's *Tennis Channel Order* Fails Substantial Evidence Test

Comcast v. FCC showed the D.C. Circuit's unwillingness to affirm Commission program carriage rulings that are unsupported by substantial evidence. The necessity of meeting this evidentiary test is not new, but the D.C. Circuit took the test seriously in this case. And its rejection of certain far-fetched FCC arguments could serve as precedent for staving off future regulatory overreach.

As Senior Judge Stephen William concluded his opinion for the court:

> Without showing any benefit for Comcast from incurring the additional fees for assigning Tennis a more advantageous tier, the Commission has not provided evidence that Comcast discriminated against Tennis on the basis of affiliation. And while the Commission describes at length the "substantial evidence" that supports a finding that the discrimination is based on affiliation…none of that evidence establishes benefits that Comcast would receive if it distributed Tennis more broadly. On this issue the Commission has pointed to no evidence, and therefore obviously not to substantial evidence.

A critical defect of the FCC's *Tennis Channel Order* was the lack of "an analysis on either a qualitative or a quantitative basis" that would "establish reason to expect a net benefit" to Comcast in carrying Tennis Channel on its basic extended tier. The D.C. Circuit rejected as "mere handwaving," the FCC's discussion about cost per ratings because of "the absence of evidence that the lower cost per ratings point is correlated with changes in revenues to offset the proposed cost increase for Tennis's broader distribution." Given the lack of evidentiary support for the FCC's ruling, the D.C. Circuit also deemed irrelevant arguments that Comcast's own cost-benefit considerations for rejecting Tennis Channel's proposal lacked rigor.

The D.C. Circuit was also unimpressed by the FCC's bootstrapping argument that a Commission-imposed remedy of *reducing* distribution of other programming might hypothetically produce a net benefit. The FCC argued that Comcast could avoid cost increases from broader distribution of Tennis Channel by *reducing* distribution of the Golf Channel and Versus. The FCC posed such a remedy in its *Tennis Channel Order*. Yet even if evidence showed removing those channels from lower priced tiers created a net benefit for Comcast, the D.C. Circuit explained, that would not bear on its rejection of Tennis Channel's proposal.

Finally, the D.C. Circuit concluded that a lack of evidence overrides FCC labeling of the record under its evidentiary procedures. The D.C. Circuit assumed the FCC correctly found a *prima facie* case of discrimination was shown and that the Tennis Channel bore the burden of proof throughout the proceeding. The FCC found the record strong enough to meet the burden. But the D.C. Circuit disagreed: "that assumption is of no use to the Commission where the record simply lacks material evidence that the Tennis proposal offered Comcast any commercial benefit."

FCC Interpreted Section 616 Contrary to Canons of Statutory Construction

A thoughtful concurring opinion in *Comcast v. FCC* by Judge Brett Kavanaugh pointed out two deeper problems with the FCC's interpretation and application of Section 616.

First, Judge Kavanaugh explained that although Section 616 was intended to be a consumer welfare-enhancing provision, the FCC's erroneous interpretation turned it into a competitor-welfare protecting provision:

> Contrary to the plain language of Section 616, the FCC stated that the term "unreasonably" modified "discriminating" not "restrain" - even though Section 616 says it applies only to discriminatory conduct that "unreasonably restrain[s]" the ability of a competitor to compete fairly... Because the FCC did not read Section 616 as written, it did not recognize the antitrust term of art "unreasonably restrain" that is apparent on the face of the statute. That erroneous reading of the text, in turn, led the FCC to mistakenly focus on the effects of Comcast's conduct on a competitor (the Tennis Channel) rather than on overall competition…That was a mistake because the goal of antitrust law (and thus of Section 616) is to promote consumer welfare by protecting competition, not by protecting individual competitors.

Judge Kavanaugh offered an alternative interpretation of Section 616 that fits with the legal meaning of "unreasonably restrain":

> Because Section 616 incorporates antitrust principles and because antitrust law holds that vertical integration and vertical contracts are potentially problematic only when a firm has market power in the relevant market, it follows that Section 616 applies only when a video programming distributor has market power in the relevant market. Section 616 thus does not bar vertical integration or vertical contracts that favor affiliated video programming networks, absent a showing that the video programming distributor at least has market power in the relevant market.

Observing Comcast's approximate 24% share in the national video programming distribution market, Judge Kavanaugh concluded that Comcast "does not possess market power in the market considered by the FCC in this case."

Second, Judge Kavanaugh concluded that the FCC's interpretation of Section 616 disregards the constitutional avoidance canon. According to this canon, a statute susceptible to more than one reasonable construction should be interpreted to avoid raising constitutional problems.

Supreme Court case law holds that video programming distributors engaging in and transmitting speech are entitled to receive First Amendment protection. Under the Supreme Court's intermediate scrutiny standard, government interference with the editorial discretion of video programming distributors is only permissible where such distributors possess market power in the relevant market.

Of course, it has been 16 years since the last major Supreme Court case addressing First Amendment aspects of MVPD regulation. Since that time, according to Judge Kavanaugh, "the video programming market has changed dramatically, especially with the rapid growth of satellite and Internet providers." Given today's competitive video market, he concluded "neither Comcast nor any other video programming distributor possesses market power in the national video programming market."

Therefore, "[u]nder the constitutional avoidance canon, those serious constitutional questions require we construe Section 616 to apply only when a video programming distributor possesses market power." So the FCC erred in applying Section 616 to find prohibited discrimination in the absence of a cable operator possessing market power. "In restricting the editorial discretion of video programming distributors," wrote Judge Kavanaugh, "the FCC cannot continue to implement a regulatory model premised on a 1990s snapshot of the cable market."

Comcast v. FCC in the Context of the Commission's Regulatory Expansion

Since 2007, the FCC has actively pursued a more aggressive approach toward program carriage regulation. This interventionist posture at the FCC appears to have been prompted, to a significant degree, by the persistent urgings of The America Channel and Wealth TV. Both entities made numerous rulemaking comment filings, *ex parte* filings, and visits to the FCC in the years leading up to and following 2007. Collectively, this activity foreshadowed an increasingly intrusive and competitor welfare-based focus for the FCC's program carriage regime – a focus culminating in the misguided, unlawful *Tennis Channel Order*.

Another episode in the FCC's continuing efforts to insinuate itself into private program carriage negotiations is the Commission's August 2011 *Order and Proposed Rulemaking* which expanded the agency's program carriage regulations in certain respects. Aspects of that rulemaking, particularly a temporary "standstill" measure imposed by the FCC, are now subject to statutory and constitutional challenges in *Time Warner Cable v. FCC*, now pending before the U.S. Court of Appeals for the Second Circuit. The reasoning in *Comcast v. FCC* may well influence the outcome of the Second Circuit case.

Also, in August 2011 the FCC proposed even more expansion of its program carriage regime. One alternative proposed by the FCC is to formally codify into regulation a shifting of the burden of proof onto the cable operator or other MVPD, once an independent programmer establishes a *prima facie* case in a program carriage proceeding. This change would further encourage the filing of competitor-welfare focused program carriage complaints. Nonetheless, *Comcast v. FCC* makes clear that the substantial evidence requirement cannot be evaded merely by the label the Commission attaches to the state of the evidence in record pursuant to its procedures.

A Consumer Welfare-Based Case for FCC Program Carriage Reform

The undoubted existence of competition in the video services market, coupled with respect for First Amendment free speech rights, should now drive program carriage regulatory reform.

First and foremost, Congress should consider eliminating program carriage regulation altogether. As Judge Kavanaugh's concurring opinion put it, "the FCC cannot continue to implement a regulatory model premised on a 1990s snapshot of the cable market." Congress ultimately bears responsibility for removing Section 616 from the books.

The FCC now has an opportunity to rethink its misguided aggressive regulatory approach to program carriage. Now is the time for the FCC to consider a deregulatory, free market approach that avoids a myopic look at the "cable" market. Instead, it must take a holistic view of the video programming choices that cable, DBS, telco entrants, over-the-air, mobile, and various Internet-based distributors now offer consumers.

After *Comcast v. FCC*, the Commission must recalibrate its program carriage regulations to account for today's convergent, platform-rivalrous video services market. The Commission should reframe its regulations to comport with the consumer welfare and market power standard that the statute calls for and which the First Amendment demands.

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Further Readings

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