

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

In the Matter of)
)
À La Carte and Themed Programming and Pricing) MB Docket No. 04-207
Options for Programming Distribution on Cable)
Television and Direct Broadcast Satellite Systems)

**RESPONSE OF THE
NATIONAL CABLE & TELECOMMUNICATIONS ASSOCIATION
TO STAFF FURTHER REPORT ON À LA CARTE**



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The National Cable & Telecommunications Association (“NCTA”) respectfully submits the following response to the “Further Report” of the Media Bureau in the above-captioned proceeding.

KEY POINTS

- In its First Report in November 2004, the Media Bureau concluded that requiring cable operators to make services available on an à la carte basis or “themed tier” basis would make most consumers worse off. The Bureau found that consumers would have to pay more than they pay today to receive far fewer channels – fewer even than the number of channels that they regularly watch, much less the channels that they occasionally watch.
- The Bureau also concluded that à la carte and themed tier requirements would significantly diminish the quantity, quality, and diversity of programming available to viewers. À la carte would cause many program networks to fail – especially networks aimed at minority and niche interests.
- The newly issued Further Report concludes that these conclusions were based on “problematic assumptions” and “incorrect and biased analysis.” Relying on alternative hypothetical assumptions, it concludes that “à la carte could be in consumers’ best interests.” But as we show, with the help of Michigan State University economist Steven Wildman, on virtually every point the assumptions, analysis and conclusions of the Further Report are incorrect, problematic and at odds with the evidence in the record:

- The Further Report identified a computational error in the Booz Allen study on which the First Report relied – but failed to correct it properly. In acknowledging its error in calculating how many à la carte channels customers could purchase without spending more than they do today, Booz Allen also identified for the Commission the two adjustments necessary to correct its error. It showed that once those offsetting adjustments were made, the effects of the error were inconsequential. The Further Report made only one of the necessary adjustments, and therefore it erroneously overstated the number of à la carte channels that consumers would be able to purchase.
- Even the Further Report acknowledges that à la carte only works, if at all, for digital services and digital customers. The costs of acquiring set-top boxes, when added to increased programmers’ costs, would severely reduce the number of à la carte channels that today’s *analog* customers – still the substantial majority of all cable customers – could purchase without paying more than they do today. Even under the Bureau’s calculations, it’s only today’s digital customers who could purchase as many as 14 à la carte cable networks without seeing an increase in their monthly bills. For the remaining 60% of cable customers, the costs and disruption of converting to analog would outweigh any benefits.
- The Further Report mischaracterized an important assumption in the Booz Allen study. The Bureau claims it was unrealistic for Booz Allen to assume that cable customers’ television viewing would decline by 25% under an à la carte regime. But Booz Allen made no such assumption. It predicted that viewership for currently tiered cable networks would decline by almost 25%, but cable customers might watch more programming on broadcast television stations or premium channels.
- The Bureau’s analysis ignores the value of channels that are only watched occasionally. Even if some customers could pay less under à la carte to receive the same numbers of channels that they regularly watch today, they would still lose the ability to view occasionally any of the other channels that are currently available to them today – and to find new favorite channels for regular viewing. Accepting the Bureau’s calculations, à la carte would allow some viewers to get as many as 14 channels for the same price they pay for as many as 150 today. The FCC’s new report does not account for the value to consumers of this lost ability to “graze” and occasionally view the diverse array of channels on the basic and enhanced basic tiers.
- The Further Report ignores the evidence on the effects of à la carte on advertising revenue. The Further Report challenges the First Report’s conclusion that à la carte would result in reduced advertising revenues, which would in turn raise subscription fees, reduce program quality and/or threaten viability of some networks. It hypothesizes that advertisers do not pay much for potential viewers who do not regularly watch a network, and that they

- might in fact pay more to reach viewers who had affirmatively chosen to purchase the network. The Further Report, however, offers mere conjecture to support this proposition. In contrast, the First Report's assumptions were based on interviews, testimony and other evidence from the advertising community.
- The Further Report ignores evidence confirming the obvious effects of à la carte on marketing costs. Again citing no evidence in the record or elsewhere, the Further Report challenges the First Report's conclusion that à la carte would significantly raise marketing costs for most program networks, compounding the effects of reduced advertising revenues. The Further Report fails to acknowledge that the costs of persuading viewers to *purchase* a program network far exceed the costs of persuading them to *watch* a network that is already available to them. Record evidence in the Bureau's proceeding confirms that marketing costs would be far greater in an à la carte environment.
 - The Bureau's economic theories are at odds with the expert economic testimony in the record. The Further Report cites economic theories and articles that suggest that "bundling" is not always beneficial to consumers and that there may be economic benefits that consumers could theoretically gain from à la carte. But it ignores the economic studies submitted by many commenting parties and the testimony of four independent academic economists who appeared at the Bureau's à la carte symposium. Those studies and the economists' testimony virtually all confirmed that in this particular marketplace, the costs to consumers of mandatory à la carte would almost certainly outweigh any benefits.
 - The Further Report confirms that à la carte will likely diminish diversity and minority-interest programming – but views this as beneficial to consumers. The Bureau acknowledges that bundling gives cable operators incentives "to add niche programming that appeals to a small set of subscribers rather than add additional mainstream programming that provides greater total value to consumers" and that, in contrast, à la carte would be likely to provide more "mainstream" programming and less "niche" programming. The Bureau views this as a *good* thing because, from an economist's perspective, it maximizes the "total value to consumers." Hundreds of commenting parties who feared the loss of programming uniquely targeted at the interests of minorities – in particular, minorities whose ability to pay for such programming on an à la carte basis might be insufficient to support it – disagree profoundly with the Bureau about the desirability of such a result.

INTRODUCTION

Two years ago, in response to requests from members of Congress, the Commission initiated an inquiry into the feasibility and effects of making programming services available to cable and satellite customers on an à la carte or “themed tier” basis. The Commission received almost 400 comments from cable operators, DBS providers, program networks, consumer groups, government officials, interest groups, consumers and other interested parties.

Several parties submitted studies and analyses by economists and others with expert knowledge of the video and advertising businesses. In addition, the Media Bureau conducted an all-day symposium at which several industry representatives – as well as four independent academic economists – discussed their views and responded to questions.

On November 18, 2004, the Media Bureau issued its 96-page “Report on the Packaging and Sale of Video Programming Services to the Public” (“First Report”). That report identified and discussed both the benefits and the harms – theoretical and real – associated with the bundling of program networks into large basic and enhanced basic tiers. Based on the array of evidence and expert analysis in the record, the Bureau concluded that any benefits were likely, in the real world, to be outweighed by the harm to consumers.

In particular, the Bureau concluded that mandating à la carte or themed tier offerings would be likely to increase costs for cable operators and program networks, result in higher bills for customers who chose to purchase more than a small handful of networks, and cause many program networks – especially those that serve niche and minority interests – to fail, adversely affecting the diversity of programming available for viewing. Consumers would pay more than they pay today to receive fewer services than they currently receive – fewer even than the number that they *regularly* watch today, and far fewer than they have available for occasional

viewing. And the quality and diversity of programming available for purchase would be significantly diminished.

Throughout its report, and in an “Economic Appendix,” the Bureau explained why it reached these conclusions. It cited and evaluated information and predictions provided by cable operators and program networks, economic studies, and the testimony of the independent economists and others at its symposium. It cited articles and evidence gleaned from news reports and other secondary material. And it cited articles in the economic literature.

The Bureau’s conclusions were wholly consistent with the symposium testimony of the four independent economists. Those economists unanimously agreed that because of the structure, economics and technology of the cable marketplace, à la carte was highly unlikely to make consumers better off and was likely to make most consumers worse off. The Bureau acknowledged that, as a matter of economic theory, bundling of goods and services does not always enhance consumer welfare and in some cases may harm consumers. But it concluded – as did the four economists – that in this particular marketplace, there was little reason to believe that consumers would benefit from requiring unbundled à la carte or themed tier offerings.

These conclusions were also consistent with other recent independent studies of the likely effects of à la carte, including a report by the General Accounting Office,¹ an analysis by Bear Stearns,² and a study by Kagan Research.³ Although it was wholly reasonable for policymakers to wonder whether à la carte offerings might enable consumers to save money by purchasing

¹ General Accounting Office, Issues Related to Competition and Subscriber Rates in the Cable Television Industry, GAO-04-8, Report to the Chairman, Committee on Commerce, Science, and Transportation, U.S. Senate (October 24, 2003).

² “A La Smart?,” Bear Stearns Equity Research Report, Mar. 29, 2004, http://www.ncta.com/a_la_carte/bear_stearns_a_la_smart.pdf

³ “Á la Carte Pricing Makes Great Theory, But TV Ch. Bundling Tough To Beat,” Kagan Insights, Dec. 15, 2005, http://www.ncta.com/a_la_carte/Kagan-Insights-12-15-05.pdf.

programming on an individual network basis, the cumulative evidence and research has shown that in terms of price, program quality and availability, and diversity, à la carte was likely to have only adverse effects on most consumers.

Now, however, barely a year after issuing its Report, the Bureau has issued a “Further Report” largely repudiating its previous conclusions. In its Further Report, the Bureau claims that its previous analysis “relied on problematic assumptions and presented incorrect and biased analysis.”⁴ It now concludes that “many consumers *could* benefit from the ability to purchase network programming on an à la carte basis.”⁵

The Further Report fails, however, to substantiate this conclusion. Its only example of “incorrect” analysis is an error made by Booz Allen Hamilton, relied upon in the First Report, in calculating the number of cable networks that cable customers could purchase on an à la carte basis without having to pay more than they currently pay to receive the entire basic and enhanced basic tiers of programming. But this error, which Booz Allen acknowledged in a letter to the Commission’s Chief Economist,⁶ does not significantly alter the ultimate conclusions of the First Report.

Even the Bureau’s “corrected” calculation still shows that most customers – including all of today’s analog customers, who constitute more than 60% of cable households – would be able to purchase fewer channels than the number that they *regularly* watch today. Today’s digital

⁴ Further Report, ¶ 2.

⁵ *Id.*, ¶ 5 (emphasis added).

⁶ Letter from John Frelinghuysen, Vice President, Booz Allen Hamilton Inc., to Dr. Leslie Marx, Chief Economist, Federal Communications Commission (Dec. 16, 2005).

customers – the only theoretical beneficiaries of the Further Report – could purchase no more than 14 cable channels for the price that they pay today.⁷

In any event, the Bureau’s correction was itself methodologically flawed and incomplete. Had the Bureau made the appropriate correction, its calculation would have confirmed that virtually *any* customers who wanted to purchase as many channels as the average customer regularly watches today would have to pay more than they currently pay for the entire basic and enhanced basic tiers.

Moreover, while purporting to challenge the Bureau’s conclusions regarding the effects of à la carte on diversity of programming, the Further Report concedes that one likely effect would be, as the Report put it, the “weed[ing] out”⁸ of program networks that appeal to minority and niche viewers unable or unwilling to pay enough to support that programming on an à la carte basis. The Further Report suggests that there might be countervailing benefits, insofar as there might be more “mainstream” programming that is more valuable to a larger number of consumers.⁹ Even if this were true, this “benefit” would not erase the fact that diversity will be diminished by an à la carte requirement, as the First Report concluded and as hundreds of commenting parties feared.

The Further Report observes that the conclusions in the First Report are based on assumptions of how cable operators, cable program networks, advertisers and consumers would behave in an à la carte environment. And it correctly notes that “using a different set of assumptions, the results *could* be significantly different.”¹⁰ But the assumptions that the Bureau

⁷ See Further Report, ¶ 14.

⁸ *Id.*, ¶ 49.

⁹ *Id.*, ¶ 70.

¹⁰ *Id.*, ¶ 8 (emphasis added).

relied upon in its First Report were not plucked from thin air. To the contrary, they were based on *evidence* and *testimony* in the substantial record compiled in the Bureau's proceeding.

Virtually *every* assumption was supported by citations to evidence in the record.

In contrast, virtually *none* of the alternative assumptions that "could," according to the Further Report, significantly alter the conclusions of the First Report are supported by citations to anything in the record. Different assumptions may lead to different results – but there is ample evidence for concluding that the assumptions relied upon in the First Report are valid, while the hypothetical alternatives put forward in the Further Report are based on nothing but unsupported conjecture.

Similarly, the Further Report, relying on economic literature, claims that the First Report's analysis of the economic costs and benefits of à la carte overemphasizes the costs and fails to recognize that "bundling" of goods and services can have costs as well. But the Bureau, in its First Report, acknowledged the fact that bundling can, in various circumstances, have both costs and benefits. It simply found that, taking into account the unique circumstances of the multichannel video programming marketplace, *the benefits of bundling significantly outweigh the costs*.

This is a conclusion supported by the four economists at the Commission's symposium. NCTA has asked one of them – Professor Steven Wildman of Michigan State University – to further explain why it is so, and also to examine the assertions, assumptions and conclusions in the Further Report. Professor Wildman's paper, attached to these comments,¹¹ provides an

¹¹ S. Wildman, "A Case for À La Carte and 'Increased Choice'?: An Economic Assessment of the FCC's Further Report" (2006), attached to this Response as Attachment A.

economic analysis of the Further Report and confirms that its criticisms of the First Report widely miss the mark.

After examining the Further Report's critique of the computational errors and biased and problematic assumptions that supposedly permeated the First Report, Professor Wildman finds that the Further Report has not "advanced any credible arguments on behalf of a policy-mandated shift to à la carte, mixed bundling, themed tiers or subscriber-selected tiers."¹² He concludes that:

As with motherhood, patriotism and the American way, it is difficult to argue against a proposal that promises to give consumers more choice. This, of course, is exactly why policy proposals cloaked in such terms merit more than usual scrutiny. This report applied such scrutiny to the cases for à la carte and the other pricing policies advanced in the Further report and found that *they do not stand up to close examination.*¹³

I. THE SINGLE "MISTAKE" IDENTIFIED BY THE FURTHER REPORT DOES NOT SIGNIFICANTLY AFFECT THE FIRST REPORT'S CONCLUSIONS

Relying on a Booz Allen Hamilton analysis submitted by NCTA, the First Report concluded that under an à la carte regime, consumers would only be able to purchase "fewer than 9 program networks" (*i.e.*, fewer than the 11 that the average customer regularly watches, and far fewer than the number currently available for occasional viewing) for the same amount that they currently pay today.¹⁴ In testimony before the Senate Committee on Commerce, Science and Transportation on November 29, 2005, Chairman Martin announced that he had asked the Media Bureau and the Chief Economist to reexamine the First Report and that they had spotted an error in the Booz Allen study on which the First Report had cited in support of its conclusions:

¹² Wildman at 28.

¹³ *Id.*, at 29.

¹⁴ First Report at 6.

The report relies on a study that makes mistakes in its calculations. For example, the report fails to net out the cost of broadcast stations when calculating the average cost per cable channel under à la carte pricing. As a result of this mistake, the report understates the number of cable channels a consumer could purchase under à la carte pricing without seeing an increase in their bill.¹⁵

In a December 16, 2005 letter to the Commission's Chief Economist, representatives of Booz Allen acknowledged the error in its initial analysis and provided the FCC with the appropriate corrections. As Booz Allen explained, *two* adjustments needed to be made to its calculations of (1) the price per channel at which operators would be expected to offer à la carte service in order to maintain the current average revenue per user, and (2) the number of previously tiered channels that the average consumer would be able to purchase on an à la carte basis without having to pay more than they pay to receive the current tiers:

Specifically, as Chairman Martin's statement suggested, revenues from the broadcast basic tier should have been excluded from the operators' video average revenue per user (ARPU) before calculating the average cost per channel under à la carte. *And* those revenues, along with revenues from premium, pay-per-view and video on demand, should also have been excluded in calculating how many à la carte channels the average consumer could purchase before facing an increased monthly cable bill.¹⁶

The Further Report, erroneously, only makes the first adjustment. It correctly excludes the broadcast tier revenues from the calculation of ARPU and average à la carte price per channel. But inexplicably it does *not* exclude those and other extraneous revenues in deriving how much money consumers would be able to spend specifically on à la carte channels without having to pay more than they do today. As a result, it pads the amount of cash available to purchase à la carte channels and so mistakenly concludes that consumers could purchase

¹⁵ Oral Statement Before the Senate Committee on Commerce, Science and Transportation, "Open Forum on Decency," November 29, 2005, p.4, http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-262484A1.pdf.

¹⁶ Letter from John Frelinghuysen to Dr. Leslie Marx, *supra* note 6.

between 10 and 14 channels without spending more than they spend today to receive tiered services.

As the Booz Allen letter showed, had the Bureau made *both* necessary corrections, it would have found that the average analog customer would be able to purchase only 6 to 8 à la carte channels, while even digital customers (who already are paying for digital boxes today) would be able to purchase only 8 to 10 cable channels. Thus, as Booz Allen noted in its letter, the corrections, if properly made, would not change the underlying conclusion of the initial analysis: “Under all of the scenarios evaluated, consumers would be able to purchase fewer than the 11 cable channels that they regularly watch today, for the same price that they currently pay to receive the entire basic and expanded basic tier.”¹⁷

The Further Report repeatedly cites the Booz Allen letter’s concession that a mistake had been made.¹⁸ But the Further Report does *not* explain why it failed to make *both* the adjustments that Booz Allen identified as necessary to correct the mistake. Bottom line: The technical mistake that the Further Report identifies in the initial Booz Allen study does not, when properly corrected, undermine or alter the conclusions of the First Report.

Even if the Further Report’s own “correction” of the mistake were methodologically sufficient, it would show only that *some* cable customers – specifically *digital* customers – could pay less than they do today and still receive more channels than the *average* cable customer watches *regularly* today. The number of these à la carte beneficiaries would likely be a small minority of viewers. That’s because digital customers currently represent only 40% of the cable universe, and not all television sets in those homes are equipped with digital boxes.

¹⁷ *Id.*

¹⁸ Further Report, ¶ 3 n.4; ¶ 6 n.8; ¶14 n.19.

But more to the point, digital customers, who typically receive over 150 channels, almost certainly want to receive more than the 11 cable channels that the average customer watches with regularity. That's why many choose to purchase digital service. Digital customers incur the additional cost of digital set-top boxes and the additional price of the digital tier in order to receive more viewing options than the 70 channels that are already available to analog customers. Whether they watch these additional channels regularly or simply want the option to watch them occasionally, it is unlikely that digital customers would view the ability to purchase 14 channels for the same price that they now pay to receive 150 channels as a significant "benefit."

Even if it were the case that *all* customers could pay less to receive the same number of channels that they regularly watch today, they would still lose the ability to view occasionally any of the other channels that are currently available to them today. The FCC's new report does not account for the value to consumers of this lost ability to "graze" and sometimes even find *new* channels for *regular* viewing. But most customers will, in fact, pay *more* to receive the same number of channels that they regularly watch today, wholly apart from losing all those occasionally viewed channels. As Professor Wildman confirms, only by "failing to acknowledge the full correction identified by [Booz Allen], which left its original conclusions basically unaltered,"¹⁹ does the Further Report reach a different conclusion.

¹⁹ Wildman at 2.

II. THE ASSUMPTIONS UNDERLYING THE FIRST REPORT'S ANALYSIS WERE BASED ON FACTS, EXPERTISE AND RECORD EVIDENCE

The Further Report challenges many of the assumptions underlying the First Report's conclusions. It speculates, for example, that viewership may not decline as precipitously as the First Report predicts. As a result, it contends, advertising revenues might not be adversely affected by an à la carte mandate – and might even increase. It hypothesizes that programmers' marketing costs might not have to increase as sharply as predicted. And, if advertising revenues are higher than projected and marketing costs are lower, then the effects on programmers will not be as severe as projected: license fees need not increase, expenditures on quality programming need not decline, and the projected failure of many new and diverse program networks need not occur.

These sanguine conclusions are all based on assumptions contrary to those relied upon in the First Report. But unlike the assumptions relied upon in the First Report, which were grounded on solid evidence in the voluminous record compiled by the Bureau, the alternative assumptions posited in the Further Report rely on conjecture.

A. The First Report Did Not Assume a 25% Decline in Television Viewing.

The Further Report contends that the First Report's predictions regarding the effects of à la carte on are "suspect" because they are based on the "questionable" assumption in the Booz Allen report that consumers would watch nearly 25% less television.²⁰ The Further Report makes fun of this assumption, suggesting that "it seems unlikely that the average consumer would spend 2 hours more reading, listening to music, or working per day instead of watching

²⁰ Further Report, ¶ 3.

television merely because he is no longer required to buy a particular channel of programming.”²¹

But that’s not at all what Booz Allen said. Booz Allen’s prediction was based on an analysis of viewership of cable networks by “heavy viewers” and by “occasional viewers.” It stated that if consumers only purchased basic cable networks that they watch most regularly and no longer had access to networks that they now watch occasionally, viewership of *cable networks* would decline, on average, by 23% – even taking into account *increased* viewing of networks by those who chose to purchase them. This does not mean that *total* television viewing would decline so sharply; cable customers may watch more programming on *broadcast* television (which cable operators are required to provide) and on *premium* channels. The Further Report simply misreports what Booz Allen stated.²²

Furthermore, the Further Report suggests that “if a customer regularly watches only 10 channels and under à la carte continues to subscribe to those 10 channels, one would not expect the time the consumer spends viewing video programming to change dramatically.”²³ But even customers who *regularly* watch only 10 cable networks may spend significant amounts of viewing time occasionally watching some of the other dozens of networks available on their basic and enhanced basic tiers. It’s not intuitively obvious, as the Further Report seems to assume, that if customers no longer choose to purchase those occasionally viewed networks, all their occasional viewing time will simply be shifted to the 10 networks they regularly watch.

²¹ *Id.*, ¶ 16.

²² *See* Wildman at 7-8.

²³ Further Report, ¶ 16.

Booz Allen's assumption that only a portion of that occasional viewing time was likely to go to regularly viewed cable networks, and that a significant amount would go to broadcast stations, premium channels, other sources of video entertainment, or elsewhere hardly seems unreasonable. But Booz Allen's assumption, unlike the Further Report's, was based not simply on intuition but on experience, interviews and research on viewing habits. And the assumption was also supported by a multitude of comments and testimony in the Bureau's proceeding. The Further Report cites nothing to support its contrary assumptions.

B. The Further Report Ignores the Evidence on the Effects of À la Carte on Advertising Revenue.

The Further Report challenges the First Report's conclusion that à la carte would result in reduced advertising revenues, which would in turn raise subscription fees, reduce program quality and/or threaten viability of some networks. In doing so, the Bureau also hypothesizes that advertisers do not pay much for potential viewers who do not regularly watch a network; and that they might in fact pay more to reach viewers who had affirmatively chosen to purchase the network.²⁴

The Further Report again offers nothing but conjecture to support this proposition. In contrast, the record in the Bureau's proceeding plainly refutes it. Booz Allen based its assumptions that advertising revenues would decline if networks lost the *opportunity* to be viewed by tier subscribers on interviews with the advertising community. Many comments in the record confirmed that this would occur.²⁵

²⁴ See Further Report, ¶¶ 48-49.

²⁵ See First Report at 43-47 and footnotes therein. See also Wildman at 9-11.

Moreover, Jon Mandel, Chief Global Buying Office for MediaCom Worldwide, an expert on media advertising who testified at the Bureau’s à la carte symposium, confirmed that advertisers rely primarily on *potential* audience and that à la carte, by reducing such potential viewership, *would* seriously diminish ad revenues. In fact, Mr. Mandel was specifically asked by the Chief of the Media Bureau whether, as the Further Notice now suggests, it might be the case that advertisers would actually pay *more* if they knew that a network’s audience consisted only of heavy viewers who chose to purchase it – and he specifically dismissed that theory as “false.”²⁶

C. The Further Report Ignores the Evidence on the Effects of À la Carte on Marketing Costs.

Again, citing no evidence in the record or elsewhere, the Further Report disputes the First Report’s conclusion that à la carte would significantly raise the marketing costs for most program networks. The Further Report says that since fewer than half of cable viewers find new channels by “surfing,” cable networks must already need to “find ways to advertise their programming to the remaining MVPD viewers.”²⁷ But the marketing issue in an à la carte regime is not the need to persuade viewers to *watch* programming that is already available to them. It is the need to persuade them to *purchase* the network in the first place, so that the programming becomes available to them – and so that cable operators (and DBS providers) will continue to choose to carry them.

Numerous cable program networks filed comments confirming that, for these reasons, their marketing costs would increase – in some cases, to unaffordable levels – in an à la carte

²⁶ Symposium Transcript at 61. As Mr. Mandel explained, “We know that subscribers over time will turn into viewers through trial. The key thing that all marketers know is there is no purchase without trial, and there is no trial without availability and shelf space first, and then consumer knowledge of that availability.” *Id.* at 66.

²⁷ Further Report, ¶ 54.

regime. The First Report cited these comments and described at length the experiences and predictions reported by several networks.²⁸ Moreover, NCTA and the Booz Allen report showed that premium channels (which are offered on an à la carte basis today) spend 15-25% of net sales revenues on marketing, while tiered cable program networks spend only 2-6% on marketing.²⁹

Here, the Further Report simply ignores this evidence while providing none of its own. In the face of evidence that cumulatively, unanimously and credibly supports a single conclusion, the Further Report simply speculates on possibilities that “could” or “might” occur. This is not “balance” but a disregard for the notice and comments process upon which administrative agencies must rely.

* * * *

In sum, the First Report was on solid ground in concluding that à la carte’s decreased viewership, diminished advertising revenues, and increased marketing costs would put pressures on program networks to increase their licensing fees and/or spend less on programming. This would, in turn, result in higher prices for consumers and/or further reductions in viewership, threatening the viability of many program networks. The Further Report’s suggestions that the results “could” or “might” be otherwise enjoy no empirical or evidentiary support.

III. IN THE VIDEO MARKETPLACE, THE ECONOMIC BENEFITS TO CONSUMERS OF BUNDLING FAR OUTWEIGH THE COSTS

The Further Report criticizes the First Report’s discussion of the economics of bundling as “unbalanced” because it only describes the benefits associated with bundling. According to the Further Report, the economics literature suggests that there can be both benefits *and harms* to

²⁸ See First Report at 48-51.

²⁹ See NCTA Comments at 26.

the bundling of goods and services and that “a change from bundled pricing to à la carte may either increase or decrease economic efficiency, depending on the environment.”³⁰

As Professor Wildman points out, it is true – but beside the point – that bundling can be more or less beneficial to consumers than à la carte depending on the circumstances.³¹ Indeed, *all*

the independent economists who appeared at the Bureau’s symposium (several of whose general earlier works – but not their more pertinent symposium testimony – are cited by the Further Report) recognized this truism. But what they also recognized was that *in the particular circumstances surrounding the marketing of video programming networks to cable customers*, mandating à la carte availability is much more likely to be harmful than beneficial.

For example, Professor David Waterman stated that:

[t]he overall effect of a mandatory à la carte system would really be *pretty disastrous*. I think, first of all, it would have a very negative effect on the advertising market, because advertisers would no longer have very much demand to reach such small audiences....Networks would be more dependent on their affiliate fees, but they ... can't just raise their affiliate fees. They have already raised them what they can.³²

Thus, according to Professor Waterman, “anything that you do to try to force à la carte and less bundling, almost everything you do, has some kind of negative effect, which I think is probably going to swamp other things.”³³

At the symposium, Professor Wildman agreed: “Is it possible to improve over the current situation [with some sort of à la carte regulation]? . . . Off the top of my head, I can’t think of

³⁰ Further Report, ¶ 26 (footnote omitted).

³¹ *See, e.g.*, Wildman at 15.

³² Symposium Transcript at 208 (emphasis added).

³³ *Id.* at 263.

any way.”³⁴ Professor Wildman agreed that when consumers purchase tiers of program networks “you aren’t paying for something you don’t want,”³⁵ although something you don’t want may be in the same tier. He explained that bundling “is a way to effectively price discriminate”³⁶ in a beneficial way that “tends to promote efficiency.”³⁷ Such an approach “tends to increase welfare and is a good thing.”³⁸

Professor Gregory Crawford provided similar economic explanations, noting, for example, that “there are certainly discriminatory reasons for cable systems to bundle, and ... *this may actually enhance the quality and number of cable networks that we see.*”³⁹

Professor Erik Brynjolfsson elaborated on why this is so in the case of cable television, where the marginal cost of providing cable networks to additional subscribers is very low, even though bundling may be less beneficial when there are higher marginal costs:

When a good has close to zero marginal cost, the economically efficient thing from an economy-wide standpoint is to make it available to everybody who has it at value greater than zero. So, to the extent that some people are priced out of the market by a positive price, that is a detriment to social welfare, and that tends to happen to a greater extent when things are priced à la carte than when the price is bundled.⁴⁰

Professor Brynjolfsson also confirmed the effects of à la carte requirements on program diversity:

Disproportionately hurt are the small, not widely watched content channels. When you go to à la carte, their subscriptions and their revenues fall disproportionately. Conversely, when you add them as part of the bundle, they’re

³⁴ *Id.* at 267.

³⁵ *Id.* at 188.

³⁶ *Id.* at 184.

³⁷ *Id.* at 187.

³⁸ *Id.*

³⁹ *Id.* at 256 (emphasis added).

⁴⁰ *Id.* at 212.

the ones that benefit the most. So, going to à la carte is going to disproportionately reduce the amount of product variety and obscure channels or viewpoints that are available as compared to bundles.⁴¹

As Professor Wildman points out in his attached paper, it's not just that the unique cost factors associated with diminished advertising revenues and increased marketing expenses that decidedly tip the cost-benefit analysis in favor of bundling of cable networks. It's also that the presence of competition in a marketplace makes it highly unlikely that *mandating* some form of à la carte availability will do anything but make consumers worse off: "This ambiguity as to whether intervention will make things better or worse is reduced as the market for MVPD services becomes more competitive, and would largely vanish for a fully competitive MVPD market."⁴²

In a marketplace where consumers can choose from among at least three vibrant MVPD competitors (and with telephone companies increasingly deploying an additional competitive alternative), "[s]elf interest (the need to retain customers) will compel competitive firms to select the pricing strategy their customers prefer. Interfering with this process by mandating a pricing rule is likely to do more harm than good."⁴³ If à la carte appears to be a more efficient means of maximizing value to consumers, one or more competitors can be expected to offer services in such a manner.⁴⁴

⁴¹ *Id.* at 212-13.

⁴² Wildman at 18.

⁴³ *Id.* at 20.

⁴⁴ As Professor Wildman notes, the Further Report suggests that some program networks might refuse to allow their programming to be offered on an à la carte basis even if operators wanted to do so. But he suggests that whether such determinations at the wholesale level by program networks are or are not efficient and pro-competitive similarly depends on the circumstances: "[T]he questions that would have to be answered to determine whether bundling is or is not an efficient practice at the wholesale level are no less complex than those we wrestle with in evaluating retail prices. Given that wholesale prices in this industry are considerably less studied than retail prices, any proposal that policy should promote à la carte to address problems with the wholesale pricing of networks is more than a bit premature." Wildman at 22.

The fact that competing MVPDs have not generally done so would suggest that, at least in the current environment, à la carte is *not* the best way to maximize consumer value – even if we did not know exactly why.⁴⁵ But the evidence and studies in the record of the FCC’s proceeding tell us exactly why: The costs of converting to digital technology, the adverse effect on viewership and advertising revenues, the increased marketing costs, and the resulting upward pressure on subscriber fees would force cable customers to pay more to get fewer channels than they regularly watch today – and many fewer than they currently receive and occasionally view. Moreover, as discussed in the next section, it would reduce the quantity, quality and diversity of the networks available to be purchased.

IV. THE FURTHER REPORT DOES NOT REFUTE THE FIRST REPORT’S CONCLUSION THAT À LA CARTE WILL DIMINISH DIVERSITY OF PROGRAM OFFERINGS

A key finding of the First Report was that an à la carte mandate would be likely to diminish the diversity of programming currently available on cable systems. In that report, the Bureau concluded that “[t]he financial impact of à la carte sales or themed tiers on many program networks, especially smaller networks, likely would lead to the demise of a substantial number of these entities, which will reduce the overall universe of channels.”⁴⁶ Moreover, “the most likely to feel the brunt of such a mandate would be networks serving small niche interests, such as religious programming, programming aimed at minority interests, arts programming and independently owned networks.”⁴⁷

⁴⁵ The same is true for the three alternatives to pure à la carte suggested in the Further Report: “Mixed bundling, themed tiers, and subscriber-selected tiers are all more sophisticated mechanisms for price discrimination than is simple bundling. The fact that none of the options has been widely adopted is itself convincing evidence that the costs of implementing these strategies are substantial and likely more than offset the benefits of doing so.” *Id.* at 3.

⁴⁶ First Report at 118.

⁴⁷ *Id.* at 6.

The Further Report does not seriously dispute this finding. To the contrary, the Further Report generally concedes that à la carte is likely, in its words, to “weed out” some currently viable program networks.⁴⁸ And it concedes that a likely result is that program networks that appeal to minority and niche interests will disappear and be replaced, if at all, by middle-of-the-road programming that is directed at “mainstream” audiences.⁴⁹

But the Bureau now suggests that there are countervailing *benefits* to eliminating some existing programming networks and replacing minority-interest networks with more mainstream programming. According to the Further Report, when cable operators bundle program networks in tiers, they “may prefer to add niche programming that appeals to a small set of subscribers rather than add additional mainstream programming that provides greater total value to consumers. . . . In contrast, under à la carte, the example shows that the most valued programming is provided.”⁵⁰

Thus, the Further Report criticizes the First Report for

fail[ing] to note that bundling may result in the production of programming for which the consumer value is less than the cost of production, leading to an inflated supply of programming. *If a switch to à la carte eliminated such programming, the result would not be a blow to program diversity, as the First Report suggests, but rather a restoration of programming to an efficient level, more consistent with consumer value.*⁵¹

The Further Report is simply wrong to claim that this “would not be a blow to program diversity.” How could the replacement of niche and minority-interest programming with more “mainstream” programming *not* be a blow to diversity? Maximizing aggregate “consumer

⁴⁸ Further Report, ¶ 49.

⁴⁹ See, e.g., *id.*, ¶ 70.

⁵⁰ *Id.*

⁵¹ *Id.*, ¶ 73.

value” is not the same thing as maximizing diversity. While it’s not at all clear that eliminating niche and minority-interest channels and adding more “least common denominator” programming would, in fact, enhance aggregate consumer welfare, it certainly *would* adversely affect the important public policy interest of diverse expression. Hundreds of commenting parties in the Commission’s proceeding and of policymakers, deemed the effect on diversity to be enormously relevant and important.

CONCLUSION

The Further Report purports to examine the costs and benefits of à la carte more rigorously than the First Report. In fact, it is less rigorous and more error-ridden. The Further Report points out that, in theory, à la carte *could* be beneficial for consumers. It suggests that, in theory, advertising revenues *might* not decline and marketing costs *may* not increase so significantly as to have an adverse impact on subscriber fees and on the quantity, quality and diversity of cable network programming. But unlike the Further Report, the First Report based its conclusions not simply on what *could* occur but on an extensive record that showed what most likely *would* occur.

The computational “mistakes” that the Further Report spotlights turn out, when properly corrected, not to alter significantly the findings of the First Report. The “problematic assumptions” of the First Report are, as shown by Professor Wildman, more grounded in the facts and circumstances of the video marketplace – and in the record – than the conjectures of the Further Report.

The First Report showed that requiring cable operators to make programming available à la carte would force most consumers to pay more in order to receive and watch less cable programming and would cause many networks (especially niche and minority-interest networks)

to fail. The Further Report's analysis does not, in fact, undermine – and therefore should not obscure – these important findings.

Respectfully submitted,

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