United States Senate

COMMITTEE ON
HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS
WASHINGTON, DC 20510-6250

February 6, 2017

The Honorable Ajit Pai
Chairman
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Dear Mr. Pai,

I write to provide comment on the proposed Federal Communications Commission (FCC) rule on "Promoting the Availability of Diverse and Independent Sources of Video Programming" released on September 29, 2016.[1]

Millions of Americans rely on their cable, satellite or telecommunications provider to watch entertainment, news and other programming. Given the importance of this industry, the Subcommittee undertook an investigation into potential anticompetitive behavior among distributors and networks. After reviewing confidential documents from many of the largest cable and satellite providers and conducting dozens of interviews with television distributors and networks alike, I found that unconditional most favored nation (MFN) clauses and overly restrictive alternative distribution method (ADM) clauses may be limiting the number of choices that consumers have for viewing and purchasing content.

If adopted, the FCC's proposed rule will prohibit certain types of MFN and ADM contract provisions as a means of removing "marketplace obstacles that may hinder independent programmers from reaching consumers."[2] Based on the Subcommittee's investigation, I believe that by limiting both unconditional MFN clauses and overly restrictive ADM clauses, the FCC's rule will succeed in removing these obstacles and facilitate competition in an industry increasingly dominated by only a few large companies.

I. Background

Cable, satellite and telecommunication television providers are collectively known as multichannel video programming distributors (MVPDs), and range in size from large companies such as Comcast and DirecTV, which have millions of subscribers, to local cable operators that may only have several thousand. Additionally, a growing number of Americans consume

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[1] Federal Communications Commission, Proposed Rule, *Promoting the Availability of Diverse and Independent Sources of Video Programming* (September 29, 2016) (FCC 16-129).

[2] Federal Communications Commission, Proposed Rule, *Promoting the Availability of Diverse and Independent Sources of Video Programming* (September 29, 2016) (FCC 16-129).

content that is distributed online, known as Over-the-Top (OTT) content, by online video distributors (OVDs). MVPDs do not generally produce the content that television viewers actually watch. Rather, MVPDs are the pipeline to viewers for content produced by separate companies. For example, movie and television studios hire producers, writers, and actors, among others, to develop programming.[3] Programming is protected by copyright, and content owners and producers sell the rights to use their content in exchange for financial compensation, typically referred to as a licensing fee or royalty.[4]

In 2012, there were seven companies that accounted for roughly 95% of all television viewing hours in the United States.[5] In addition to owning studios that develop content, all of these companies also own broadcast and cable networks that purchase the content. Each programming company frequently provides MVPDs with multiple networks. For instance, the Walt Disney Company (Disney) provides content from the ABC broadcast network, the ESPN sports network, and the Disney Channel entertainment network, among many others. Relatively rarer are "independent networks," which are not owned by or affiliated with a major broadcaster, MVPD, or media conglomerate company.

After licensing content from a variety of content creators, programmers aggregate the content into networks. Cable and broadcast network owners negotiate with distributors, including cable, satellite, and other types of distributors, regarding the distribution rights for the networks. MVPDs develop packages with multiple channels by negotiating with companies for carriage of their networks. When these negotiations are successful, the MVPD and the programmer agree to a multi-year television programming contract (also known as a carriage, affiliation, or retransmission agreement)[6] that outlines how much the MVPD will pay the network in order to carry the programming for each of the MVPDs subscribers (a "per subscriber rate" or "net effective rate").[7] Since each MVPD and programmer negotiate the terms of these contracts separately, the contracts include non-disclosure provisions and are considered

[3] Government Accountability Office, *Video Marketplace, Competition is Evolving and Government Reporting Should Be Reevaluated* (June 2013) (GAO-13-576) (p. 2).

[4] Government Accountability Office, *Statutory Copyright Licensing, Implications of a Phaseout on Access to Television Programming and Consumer Prices are Unclear* (November 2011) (GAO-12-75) (p. 4).

[5] The seven companies were: CBS, Discovery Communications, Disney, NBC Universal, News Corporation, Time Warner, and Viacom. Government Accountability Office, *Video Marketplace, Competition is Evolving and Government Reporting Should Be Reevaluated* (June 2013) (GAO-13-576) (p. 6-7).

[6] Retransmission agreements specifically refer to contracts for the carriage of local television broadcast stations, rather than cable networks.

[7] In some cases, particularly with respect to new untested networks, MVPDs may not pay to carry the network, or the programmer may pay the MVPD to carry the network so that the programmer can build an audience and generate advertising revenue.

confidential and extremely sensitive. Through its investigation, the Subcommittee had rare access to review these agreements.[8]

II. Growth in Online Content Availability

Over the past several years, companies have explored making video content, including programming traditionally provided via MVPD subscription services, available over the internet. OVDs vary in terms of their business models, including whether they provide access to content that has previously aired on networks, access to original content, access to real-time content that is offered on traditional television networks, or some combination of this programming.

While recent estimates of households subscribing to video services from MVPDs range as high as 89%, the growth in OTT content has posed a potential challenge to MVPD dominance.[9] To date, there has been an increase in the number of households that have stopped subscribing to MVPD-provided video services (referred to as "cord-cutters"), households that reduced their cable packages ("cord-shavers"), and households that have never subscribed to such services ("cord-nevers.")[10] Industry stakeholders differ regarding the extent to which consumers have replaced MVPD-provided video services with programming provided over the

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[8] These agreements and other confidential MVPD and programmer documents provide the basis for findings and examples. Out of respect for the sensitivity of the information provided, these documents are identified as "Internal PSI documents."

[9] Federal Communications Commission, *In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Sixteenth Report (April 2, 2015) (para. 135); "Although MVPDs have traditionally considered other MVPDs their foremost rivals, MVPDs increasingly see themselves competing with OVDs for viewers, subscription revenue, and advertising revenue." Federal Communications Commission, *In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Seventeenth Report (May 6, 2016) (para. 61);

[10] In 2015, the Pew Research Center reported that 15% of Americans surveyed had canceled paid cable or satellite service, and that many of these cord cutters stated that affordability, as well as the availability of content from the internet and other sources, were factors in their decision to cancel paid television service. Cord cutters, when combined with the percent of Americans surveyed who have never subscribed to cable or satellite service (9%), amount to 24% of Americans surveyed that do not receive cable or satellite service at home. Pew Research Center, *Home Broadband 2015* (December 21, 2015) (online at: http://www.pewinternet.org/2015/12/21/2015/Home-Broadband-2015/PDF) (p. 3, 7); *See also*, Federal Communications Commission, *In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Seventeenth Report (May 16, 2016) (para. 61).

internet.[11] Nonetheless, MVPDs have taken steps to address the competitive pressures introduced from OVDs, including providing their subscribers with access to online content through TV Everywhere platforms, and including contractual provisions that limit distribution of content over the internet.[12] To this end, MVPDs and programmers negotiate limits on the distribution of programming via the internet through ADM provisions.

III. Use of Most-Favored Nation Provisions

When networks and MVPDs negotiate the terms of program carriage, they typically include MFN provisions in their agreements. MFN provisions are used in a variety of industries, and are used by one party to promise that it will give the other party at least as favorable contractual terms as it gives any other counterparty.[13] For example, if a programmer and an MVPD sign an agreement that includes an MFN regarding the price of programming, then the programmer is restricted from offering another MVPD a lower price for the same programming. If it does so, it must offer the first MVPD the lower price as well.

MFN provisions vary with respect to their scope and the conditions under which they apply. For example, MFN provisions can be size-based, non-size-based, or by-name. Non-sized based MFNs are also known as universal MFNs because they prevent the programmer from offering any other distributor a better rate, regardless of the distributor's size. A programmer who signs an MFN with one MVPD must offer that MVPD the best rate it offers any other MVPD, regardless of any size discrepancies between MVPDs. In contrast, sized-based MFNs refer to restrictions that are determined by a minimum or a maximum number of subscribers. For example, a sized-based MFN could require that a programmer offer the MVPD the same rate it offers any other provider with an equal or fewer numbers of subscribers. On the other hand, a by-name provision would include or exclude the names of companies to which the MFN applies. An example of a by-name provision would be an MFN between a provider and an MVPD that specifically allowed one MVPD to license the provider's programming at a lower price than it was provided to the MVPD.[14]

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[11] Federal Communications Commission, *In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Sixteenth Report (April 2, 2015) (para. 215).

[12] TV Everywhere platforms are an additional service option provided with a traditional MVPD subscription. Using these services, MVPD subscribers can access certain movies and television shows online via a variety of devices including personal computers, mobile devices, and televisions. Federal Communications Commission, *In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Sixteenth Report (April 2, 2015) (fn. 22).

[13] Johnathan Baker and Judith Chevalier, *The Competitive Consequences of Most-Favored-Nation Provisions*, Antitrust, Vol 27, No. 2 (Spring 2013).

[14] Internal PSI document.

An MFN provision can also specify which economic and non-economic terms in the agreement receive the MFN protection. For example, an economic MFN could apply to the per subscriber rate the MVPD pays the programmer, or to other economic provisions, such as the amount of volume discounts offered to the MVPD (agreements may offer a lower per subscriber rate as the number of subscribers served by the MVPD increases).

Non-economic terms of an MFN provision may cover "any material non-economic term, provision, covenant or consideration, that is more favorable to such third party than [to the signatory MVPD]….,"[15] though some contracts specifically outline which sections fall under the MFN provision. For example, a contract may indicate an MFN on terms related to packaging, advertising time, content, technology, systems, auditing rights, or distribution rights.[16] Of particular interest are the technology or ADM MFNs that specifically relate to the distribution of content over the internet. These MFNs control how content is distributed and to ensure that programmers do not distribute content through a third party unless the provider also has the same terms for distribution. Specific terms may include the amount of content, the file format, refresh rates, advertising rights, the number of subscriber profiles allowed to view content, and fast forward disabling.[17]

Finally, MFNs can be conditional or unconditional with respect to what steps the MVPD must take in order to benefit from an MFN offer. Conditional MFNs require that in order to receive the benefit of a lower rate or better term offered to a competitor, the MVPD must also accept any conditions tied to the offer of a better rate or term. For example, if a programmer offered another MVPD a reduced per subscriber rate conditioned on the programmer's network being offered on a better tier, or receiving some other material benefit, then the protected MVPD would have to match that term in order to receive the benefit of the reduced rate. On the other hand, an unconditional MFN does not require the protected MVPD to match any improved terms in order to receive the reduced rate offered to competitors.

A. MFNs Can Hinder Competition in Markets

Researchers and policymakers have noted that MFNs can provide benefits for markets, but have cautioned that these benefits should be weighed against the ways in which MFNs can hinder competition in markets.[18] With respect to market benefits, researchers have noted that MFNs may: 1) help address negotiating problems where one party benefits from delaying the transaction in order to receive an increased price; 2) lower prices in markets where a supplier can

[15] Internal PSI document.

[16] Internal PSI document.

[17] Internal PSI document.

[18] MFNs may harm competition by facilitating coordination, decreasing incentives to bargain, raising rival company entrant costs, and increasing seller bargaining power. Jonathan Baker, American University Washington College of Law, *Presentation: Competitive Harm from MFNs: Economic Theories* (Sept. 10, 2012).

keep the prices they charge different buyers secret; and 3) provide brand protection by ensuring that programmers do not offer the same programming to another distributor at a drastically reduced rate.[19] Similarly, MVPDs and programmers have noted the benefits of MFNs in addressing negotiation problems and facilitating entry for some firms. For example, one large programmer noted that MFNs can give a level of comfort to distributors that are the first to pursue a new distribution outlet, technology, or method of doing business.[20] Another programmer stated that MFNs were initially used to provide some protection to MVPDs that were carrying new networks.[21] Additionally, MVPDs state that it can be difficult to determine the cost and value of new independent networks and how many subscribers will be gained based on concepts and business plans of unproven independent networks.[22] Thus, an MFN can protect MVPDs who take a risk on carrying the network by ensuring that competitors do not obtain more favorable terms once the network is launched.

Despite these supposed benefits, researchers and policymakers contend that MFNs can harm competition by: 1) excluding competitors and 2) facilitating collusion and reducing price competition. The result of such anti-competitive outcomes can be limited competition, increased prices, and limited innovation. While economic analyses and case law have supported the proposition that horizontal agreements between competitors can have anticompetitive effects; analyses of vertical agreements (such as MFNs between a buyer and a supplier) can be more complicated.[23] As such, it is important to understand the particular effect that MFNs may have on the market in the MVPD industry.

1. MVPDs Have Used MFNs and Affiliation Agreements to Exclude Potential Rivals in the Past

[19] Smith Johnathan Baker and Judith Chevalier, *The Competitive Consequences of Most-Favored-Nation Provisions,* Antitrust, Vol 27, No. 2 (Spring 2013); Bill Toth, *How Parallel Most Favored Nation Clauses in Television Industry Exclude Competitors and Stifle Innovation*, The Columbia Science and Technology Law Review (Fall 2013); Stephen Smith, *When Most Favored is Disfavored: A Counselor's Guide to MFNs,* Antitrust, Vol 27, No. 2 (Spring 2013).

[20] Permanent Subcommittee on Investigations, Interview of Disney Programming Distribution official (Oct. 20, 2015) (p. 9).

[21] Permanent Subcommittee on Investigations, Interview of Company Programming Distribution official (Oct. 15, 2015) (p. 3). The Subcommittee conducted dozens of interviews over the course of its investigation. Because of the sensitivity of MFNs in carriage negotiations, several companies requested that their participation in the investigation be kept confidential.

[22] Government Accountability Office, *Media Programming, Factors Influencing the Availability of Independent Programming in Televison and Programming Decisions in Radio* (March 2010) (GAO-10-369) (p. 20).

[23] Fiona Scott-Morton, *Contracts that Reference Rivals*, Department of Justice Presentation at Georgetown University Law Center Antitrust Seminar (April 5, 2012).

In the past, the Department of Justice (DOJ) has taken action to prevent cable companies from using MFNs in a manner that would exclude new entrants to the market. For example, in 1993, DOJ filed a complaint alleging that cable operators had used MFN clauses in their agreements with programmers to restrict market entry by new satellite competitors.[24] In this case, subsidiaries of the seven largest cable companies at the time, as well as other cable companies and a subsidiary of General Electric formed a joint venture partnership called Primestar to launch their own satellite service. DOJ alleged that this partnership was formed to raise barriers to entry by other satellite providers by "restraining the availability of partner-controlled or owned programming to possible entrants, discouraging other, non-defendant programmers from making their programming available to other [satellite] entrants ..., and facilitating a coordinated retaliatory response by the ... defendants to [satellite] entry by others." The defendant cable companies, in addition to being major cable service providers, also held companies that supplied popular cable programming, such as HBO, Showtime, Cinemax, MTV, BET, Nickelodeon, E! Entertainment, CNN, The Discovery Channel, and Lifetime. The partnership agreement between the joint venture companies included an MFN clause that required partner programmers to offer programming to Primestar at terms no less favorable than provided to other distributors, and to provide Primestar at least three years in which to accept the programming. Under the MFN, any partner in the joint venture that supplied programming to a new satellite provider would have had to notify all the other partners in the joint venture (thereby enabling a retaliatory response), as well as offer the same terms to Primestar. DOJ noted that due to the size of the cable companies involved in the joint venture (collectively controlling access to a majority of cable households), any cable programmer who provided programming to a satellite competitor "would do so only at the risk of coordinated retaliation from the [cable operator defendants]."

In 1994, DOJ and the defendants agreed to a consent decree that prevented the defendants from enforcing provisions of the partnership agreements that affected the availability or price of programming to any provider of subscription television, or from retaliating against any party that supplied programming to other providers of subscription television service. In response to concerns that cable companies would restrict satellite entrants' ability to access programming from cable-affiliated networks, FCC passed program access rules.[25]

2. MFNs Have Become Ubiquitous in MVPD Carriage Agreements, and Are Used By Large Programmers and Distributors

[24] *United States v. Primestar Partners, L.P.*, 1994 U.S. Dist. LEXIS 14978 (S.D.N.Y. Apr. 4, 1994).

[25] Federal Communications Commission, *Commission Affirms Program Access Rule on Exclusive Contracts for Satellite Programming* (Docket 92-265) (Dec. 15, 1994).

Some researchers and industry representatives have found that MFNs can raise anticompetitive concerns when they are used by dominant firms, or they are widely used throughout an industry.[26] Both of these scenarios apply to the cable industry.

Today, the cable industry is both concentrated with respect to distribution, and with respect to development of programming.[27] In interviews with Subcommittee staff, representatives for programmers and MVPDs noted that MFN agreements have become ubiquitous in carriage agreements, particularly in agreements with large MVPDs.[28] Subcommittee staff confirmed this through reviews of non-public documents provided by MVPDs.[29] For example, two of the top MVPDs in terms of number of households served noted that most of their agreements with programmers include MFNs.[30] Specifically, one MVPD disclosed that 85% of its agreements contain one or more MFN provisions. The other MVPD identified MFN provisions in its agreements with at least 162 networks.[31] Most of these agreements included economic and non-economic provisions, including MFNs on the rate paid for the network. Based on the subcommittee's review of documents, MFNs were included in agreements with large programming groups, as well as smaller independent programmers; however, the ability to obtain MFNs may be dependent on the leverage of the MVPD. For example, representatives of smaller MVPDs told the Subcommittee that they are usually unable

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[26] Johnathan Baker and Judith Chevalier, *The Competitive Consequences of Most-Favored-Nation Provisions,* Antitrust, Vol 27, No. 2 (Spring 2013); Bill Toth, *How Parallel Most Favored Nation Clauses in Television Industry Exclude Competitors and stifle Innovation,* The Columbia Science and Technology Law Review (Fall 2013); Stephen Smith, *When Most Favored is Disfavored: A Counselor's Guide to MFNs,* Antitrust, Vol 27, No. 2 (Spring 2013).

[27] FCC estimated that approximately 38 percent of U.S. homes have access to at least four MVPDs. In its most recent annual report on competition, the FCC identified 94 national networks affiliated with the top six cable MVPDs (and 44 HD networks). In particular, Comcast had ownership interests in 52 national networks (24 in HD), Time Warner Cable had ownership interests in four national networks (two in HD), Cox had ownership interests in six national networks (three in HD), Bright House had ownership interests in 26 national networks (12 in HD) and DIRECTV had affiliation with six national networks (three in HD). Federal Communications Commission, "In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming," Seventeenth Report (May 6, 2016).

[28] Permanent Subcommittee on Investigations, Interviews of Officials from Multiple Programming Companies (Sept. 28, 2015; Oct. 8, 2015; Oct. 22, 2015).

[29] These documents included agreements and contracts that are rarely seen by the public due to their sensitive nature.

[30] Internal PSI Documents.

[31] Internal PSI Documents. The documents provided to the Subcommittee were partially redacted, so it is possible there are more agreements that contain MFN provisions.

to secure MFNs in their agreements with programmers.[32] Additionally, at least one programmer was also subject to unconditional MFNs in which the protected MVPD could receive the benefit of a reduced rate or better contract term without having to match any concessions that its competitors made in order to gain the more beneficial term.[33] Finally, some MFNs apply to MFN provisions themselves, meaning that if another MVPD receives a more beneficial MFN from a programmer, then the programmer must offer the better MFN to the protected MVPD.

3. MFNs and Affiliation Agreements May Reduce Competition in Video Distribution by Establishing Price Floors and Limiting Price Competition

Researchers and regulatory agencies have noted that MFNs can result in higher—not lower—prices, particularly if their use becomes ubiquitous in an industry, as it has in the cable industry. [34]

By requiring sellers to give the MFN-protected buyer the lowest price it offers to any buyer, an MFN discourages the seller from offering a discounted price to any other buyers. This can effectively set a price floor for the product.[35] The Subcommittee found that many MFN

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[32] Permanent Subcommittee on Investigations, Interview of Independent Telephone and Telecommunications Alliance member officials (Oct. 30, 2015). In addition, *see* Senate Judiciary Committee, *Hearing on The AT&T/DIRECTV Merger: The Impact on Competition and Consumers in the Video Market and Beyond, American* Cable Association Testimony (113th Cong.) (June 24, 2014): "I would say from the other side as a smaller operators who often don't get MFN deals...when they negotiate with programmers and they sometimes try to ask for different types of deals -- creative deals, deals that might address their particular circumstances, programmers often tell them I can't do that. And the implication is it's because they will implicate MFN provisions that are in larger providers' deals."

[33] Permanent Subcommittee on Investigations, Interview of Company Programming Distribution official (Oct. 7, 2015) (p.2).

[34] Jonathan Baker, American University Washington College of Law, Presentation "Competitive Harm from MFNs:Economic Theories" (Sept. 10, 2012); Stephen Smith, *When Most Favored is Disfavored: A Counselor's Guide to MFNs,* Antitrust, Vol 27, No. 2 (Spring 2013); Bill Toth, *How Parallel Most Favored Nation Clauses in Television Industry Exclude Competitors and Stifle Innovation*, The Columbia Science and Technology Law Review (Fall 2013).

[35] For example, in a complaint filed against Delta Dental of Rhode Island, the DOJ alleged that Delta Dental, which served 35—40% of people with dental insurance in Rhode Island, had MFN agreements with about 90% of the state's practicing dentists, used MFNs to restrict dentists from lowering prices and from participating in other insurers' discounted plans. In this case, these agreements restricted the dentist from charging non-Delta Dental patients less than the fees established for Delta Dental patients. If the dentist did offer non-Delta Dental

provisions require networks to compare all deal terms and provide annual MFN certification letters to MVPDs that often include "give backs" based on new deals with other MVPDs. Through these certification letters, MFNs can effectively force networks to inform MVPDs about what their competitors are doing, as well as provide them additional concessions. The result has been called identical to collusion—except that MVPDs don't have to collude, since the MFNs require the programmers to perform that function for them. Additionally, MFN provisions can be enforced through the use of audits by third parties. The relatively small group of "independent auditors" used by multiple MVPDs may also provide "clues" and/or direction to another MVPD as to what their competitors are doing and on which networks to focus audit resources.[36]

Researchers have also noted that by using an MFN, sellers are committing to compete less aggressively since they are unable to offer discounts. Buyers may be less likely to bargain aggressively for two reasons: (1) they feel that the MFN protects them from paying more than their competitors and thus may be more willing to accept supra competitive prices; and (2) as the use of MFNs grows, a buyer is less likely to negotiate aggressively, since its competitors will receive any benefit it manages to obtain.[37] A former MVPD executive stressed the need to reevaluate the use of MFNs in the cable industry, stating that, "more often than not, the MFN results in inflated rates for content that might not otherwise survive in a free-market environment (yeah, you may be overpaying, but so is everyone else)."[38]

Despite the longstanding use of MFNs and the counterargument that these provisions keep programming costs down, MVPDs have repeatedly highlighted the increase in programming costs as one reason for the increasing cost of video subscription services.[39] In fact, in its assessment of competition in the cable industry, FCC cited data showing that MVPD

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patients services at lower prices, he or she would have to offer the same price for all Delta-Dental patients. Delta Dental of Rhode Island consented to a final judgement in which it agreed to refrain from using MFN clauses in their agreements with participating dentists. *U.S. v. Delta Dental of Rhode Island*, Civil Action No. CA 96 113(D.R.I. 1996).

[36] Internal PSI document.

[37] Bill Toth, *How Parallel Most Favored Nation Clauses in Television Industry Exclude Competitors and stifle Innovation*, The Columbia Science and Technology Law Review (Fall 2013); Johnathan Baker and Judith Chevalier, *The Competitive Consequences of Most-Favored-Nation Provisions*, Antitrust, Vol 27, No. 2 (Spring 2013); Stephen Smith, *When Most Favored is Disfavored: A Counselor's Guide to MFNs*, Antitrust, Vol 27, No. 2 (Spring 2013).

[38] MFN Clause Favors No One in Carriage Negotiations.

[39] http://www.nbcnews.com/business/business-news/cable-satellite-tv-costs-will-climb-again-2016-n484531; Permanent Subcommittee on Investigations, Interview of Comcast official (March 26, 2015); Permanent Subcommittee on Investigations, Interview of TWC official (March 17, 2015); Permanent Subcommittee on Investigations, Interview of Charter official (March 13, 2015); Interview of DirecTV official (March 3, 2015); Permanent Subcommittee on Investigations, Interview of Dish official (March 16, 2015).

programming expenses as a percent of MVPD video revenue have risen from 34.6 percent in 2006, to 44.6 percent in 2013. FCC also reported that the average monthly price for basic cable service and expanded basic service increased 4.2% and 3.3% respectively, from 2013 to 2014.[40]

4. MFNs, Combined with the Use of Bundling Arrangements and Other Contract Provisions, May Inhibit Competition from Independent Programmers and Internet Distributors

Economists and industry representatives have found that MFNs may work to exclude smaller rivals and new entrants to the market, thereby limiting innovation that may benefit consumers. This may be exacerbated by other practices that are enforced through affiliation agreements between MVPDs and programmers, including channel bundling and restrictions on alternative distribution methods. In the carriage agreements the Subcommittee reviewed, MVPDs typically purchased a "bundle" of channels from larger programmers, which included popular "must-have" networks, as well as niche, new, or less popular networks.[41] Economists have argued that because an MVPD is purchasing multiple channels, they receive discounts on the "must-have" channel, and consumers gain a net benefit from a cheaper per-channel price than they would if channels were offered on a stand-alone basis.[42]

That said, MVPDs may react to the additional costs incurred from MFN-induced price floors, along with the requirement that they carry multiple niche networks, by limiting their carriage of or fees for independent programmers. One former MVPD executive stated that the "unspoken reality is that the MFN, coupled with the tying of services, is what keeps underperforming and unneeded networks in prime channel locations while struggling independents, with genuine grassroots followings, remain off air."[43] For example, in 2013, Cablevision sued Viacom for imposing substantially higher license fees (described in the

[40] Federal communication Commission, *In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Sixteenth Report (April 2, 2015) (p. 57); Federal Communications Commission, "In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming," Seventeenth Report (May 6, 2016) (p. 30).

[41] Bill Toth, *How Parallel Most Favored Nation Clauses in Television Industry Exclude Competitors and stifle Innovation*, The Columbia Science and Technology Law Review (Fall 2013); Subcommittee Review of Affiliation Agreements.

[42] Gregory S. Crawford and Ali Yurukoglu, *The Welfare Effects of Bundling in Multichannel Markets*, American Economic Review (2012).

[43] Ken Tolle, *MFN Clause Favors No One in Carriage Negotiations*, Television Week (March 17, 2008).

complaint as a 10-figure penalty) for its core networks (Nickelodeon, Comedy Central, BET, and MTV network) unless Cablevision agreed to carry a dozen other Viacom-owned networks.[44] In

the complaint, Cablevision stated, "Cablevision has identified other general programming networks that Cablevision would prefer to distribute in place of the Suite Networks, including new networks it has not carried in the past as well as HD versions of networks Cablevision already carries in SD. Viacom's tie-in, however, forecloses Cablevision from carrying such other general programming networks." Cablevision provides some examples of networks it has delayed launching due to the bundling arrangements required by Viacom, including an independent arts network, and networks targeted toward African Americans and older viewers.

Today, new and independent networks face challenges in financing high cost operations amid considerable uncertainty regarding whether they will secure carriage on enough MVPDs to be viable.[45] The Subcommittee found that even when independent channels manage to gain carriage on an MVPD's system, they tend to receive subscriber fees far below those received by channels that receive fewer viewers, but that are associated with a large media company, and may have been negotiated as part of a bundle. MFNs can limit independent networks and MVPDs in achieving optimal negotiated results. For instance, an independent network may be willing to accept a less penetrated tier of service for a higher subscriber fee—but an unconditional MFN will give other MVPDs the right to re-tier unilaterally without having to accept the condition of paying the accompanying higher fee. Conversely, a network may be willing to accept a more highly penetrated tier of service (*e.g.*, expanded basic) or a more favorable channel neighborhood at a lower rate, but an unconditional MFN will give other MVPDs the right to the lower rate without the other obligations.[46]

New networks, even from the largest programming conglomerates, often offer an extended "free" service for their channels to an MVPD in return for inclusion of the network in the MVPD's new OTT wireless package, as a promotional offering to drive viewership. However, when a small or independent network uses these tactics, large MVPDs can demand free service for all the platforms on their MVPD systems (*i.e.*, without providing the negotiated extensive wireless distribution) based on unconditional MFNs. Similarly, with an MFN in place, independent networks may not be able to agree to a period of free carriage for new OTT services

[44] *Cablevision Systems Corp. v. Viacom Intl. Inc.* Civil Action No. 13 CIV 1278 (LTS) (JLC) (S.D.N.Y. 2014).

[45] Government Accountability Office, *Media Programming, Factors Influencing the Availability of Independent Programming in Televison and Programming Decisions in Radio* (March 2010) (GAO-10-369) (p. 20-21). According to a report cited by GAO, Fox News Network had invested over $150 million by the time it launched in 1996, but it was expected to lose up to $400 million in the next 5 years.

[46] Internal PSI document.

without MVPDs demanding that they receive free carriage for their primary (cable or satellite) services.[47]

With regard to the effect that MFNs have on rival distributors, representatives of smaller MVPDs told Subcommittee staff that they are often unable to obtain MFNs. For example, in testimony before the Senate Judiciary Committee on the AT&T-DirectTV merger, a representative from a trade association representing smaller MVPDs stated: "I would say from the other side as smaller operators who often don't get MFN deals...when they negotiate with programmers and they sometimes try to ask for different types of deals -- creative deals, deals that might address their particular circumstances, programmers often tell them 'I can't do that'. And the implication is it's because they will implicate MFN provisions that are in larger providers' deals." This statement conforms to the Subcommittee's review of MFNs, which often indicated that certain MFN provisions applied in situations in which the programmer was negotiating with smaller MVPDs.

5. MFN and ADM provisions may make it more difficult for new OTT providers to enter the market

Currently MVPDs consider OVDs to be competitors and may use MFNs and other contract terms to address this new avenue of competition. For example, during an audit of a programmer, an MVPD instructed the auditor to review the programmers' agreements with an OTT provider, as well as their agreements with traditional MVPDs, to determine whether the programmer had given any distributors a better deal in violation of the MFN.[48] In addition, the Subcommittee found emails in which MVPDs indicated concern about the potential for OTT distribution to compete with their product. For example, in one confidential email, an MVPD representative asks a programmer who is launching its own OTT service, "One question I forgot to ask is whether you plan to engage in a widespread marketing campaign for X? Since the product will potentially encourage cord cutting, it will be helpful for us to understand how it will be marketed and whether our customers are going to be encouraged to buy the product."[49] The Subcommittee also reviewed another confidential email that reinforced the potential for OVDs to disrupt the traditional cable market. In the email, an MVPD representative contacts a programmer regarding the decision of a third-party studio to sell content directly to Netflix, stating that "these kinds of deals will kill your [the programmer's] business," and indicating that the MVPD was considering dropping the network because, "the real issue is substitution. This

[47] Internal PSI document.

[48] During an audit of one programmer's agreements with competing services, the MVPD asked the auditor to review that programmer's agreements with an OVD provider. *See* Internal PSI Document.

[49] Internal PSI document.

kind of arrangement incents us to buy shows directly from [the studio] and forego the less efficient and likely much more expensive endeavor of buying the linear network at all."[50]

Many carriage agreements include ADM provisions that explicitly limit the ability of programmers to provide content to online distributors. For example, contracts may require the programmer to wait a certain amount of time before offering content via online distribution. However, in order for OTTs to become viable options for consumers seeking an alternative to traditional MVPD service, access to high-valued programming is important.[51] Based on our limited review it appeared that in some cases, independent and smaller programmers were subject to more stringent restrictions with respect to their ability to provide content to OVDs. For example, agreements between MVPDs and smaller programmers often include a "hold back" period that prohibits the programmer from offering content over the internet for periods ranging from three to twelve months after it airs on the MVPD's system, thereby eliminating the programmer's ability to offer its linear network in real-time via an OVD or its own website. Even after the hold-back period expires, the agreements often state that any content provided over the internet must not be branded or contain the logo of the network.[52] In addition, the Subcommittee found evidence of MVPDs contacting programmers to require that they not live-stream major events, although the programmers argued that this limited streaming fell within the bounds of the agreement.[53]

Additionally, programmers' incentive to provide content to OVDs is also somewhat constrained because programmers may have a vested interest in the traditional MVPD distribution model, particularly since this model has enabled programmers to package many networks onto households' cable packages.[54] For example, when Verizon announced a new TV package that would give consumers the option to purchase a slimmer base channel package and then choose among various additional "channel packs" (such as sports, kids, news, lifestyle), ESPN sued Verizon, claiming that putting the ESPN channel into an ad-on package, rather than the base package, violated its existing licensing agreement. According to press reports, radio and television channels owned by parent company Disney refused to air ads for the new Verizon

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[50] Internal PSI documents.

[51] Federal Communications Commission, *In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Seventeenth Report (May 6, 2016) (Para. 153).

[52] Permanent Subcommittee on Investigations, Interview of Company Programming Distribution representative (Oct. 19, 2015) (p.13).

[53] Internal PSI document.

[54] Government Accountability Office, Video Marketplace, Competition is Evolving and Government Reporting Should Be Reevaluated (June 2013) (GAO-13-576) (p. 7).

service.[55] At a recent conference, Disney's Chief Financial Officer noted the importance of bundling to the company, stating that that OVDs would have to buy the package of products Disney sells and offer a service that "looks very much like the existing MVPD offers." Indeed, SlingTV, which was the first OTT service to offer Disney-owned ESPN (commonly considered a must-have channel, and the most expensive channel on basic cable), also carries a number of other networks owned by Disney, such as ESPNU, Fusion, and FYI, among others. In fact, 21% of the channels provided on Sling TV are owned by Disney.

The net effect of MFNs and other contractual agreements, combined with MVPD and larger programmers' potential interest in maintaining a status quo, may make it difficult for OVD start-ups to offer a service that is substantially different in terms of price and packaging from traditional MVPD services, but still offers the benefits consumers may be attracted to. For example, the FCC cited reports that Intel abandoned efforts to launch an OTT linear service in large part due to the costs of obtaining programming.[56] The FCC noted that "content owners require content distributors to guarantee a minimum number of subscribers during a multi-year agreement, obligating the distributors to incur large fixed costs for content up front. Intel's CEO Brian Krzanich concurred that while Intel had good technology, as a start-up it lacked the scale to acquire content."[57]

Beyond price and channel availability, OTTs may struggle to gain access to other features important to consumers, such as the ability to record programming (which is not uniformly available on Sling's offered networks) or access Video on Demand. Despite these obstacles, on March 14, 2016, Sony launched the only linear OTT service (PlayStation Vue) that is not associated with a traditional MVPD (in contrast to Dish's Sling).[58] In addition, options such as recording programs and accessing content on demand are available. Sony offers three different packages, ranging in price from $29.99 to $49.99 per month (in addition to the cost of an internet connection capable of successfully delivering the service). While Sony provides an interesting

[55] Dan Frankel, Verizon: Disney ad blackouts slowed growth of skinny bundle to 9Ksubs in Q2, FierceCable (July 22, 2015) (online at: http://www.fiercecable.com/story/verizon-disney-ad-blackouts-slowed-growth-skinny-bundle-9k-subs-q2/2015-07-22).

[56] Federal Communications Commission, *In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Sixteenth Report (April 2, 2015).

[57] Federal Communications Commission, *In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Sixteenth Report (April 2, 2015).

[58] However, it is worth noting that Sony owns the third-largest movie studio in the United States.

example of how an OTT may be able to compete with MVPDs, it is a relatively new service, and it appears that its efforts to offer an even more innovative product may have been constrained.[59]

IV. Conclusion

It is clear from the Subcommittee's review of how MFNs and ADM clauses affect video programming, that these provisions may be enforcing the status quo and preventing innovation and competition. While the Subcommittee did not specifically review all unconditional MFNs it is evident from our review that these provisions may be posing unreasonable restrictions on new and small companies hoping to enter the video programming market. Similarly, unreasonable ADM restrictions may be halting the progress that OTT providers have been making in securing rights to programming and creating products that would benefit consumers. The rule proposed by the FCC is a much-needed step that may help level the playing field for small and new programmers by removing one of the many obstacles they face in trying to enter the video programming market. I hope that the FCC considers the long-term effects that both of these contractual provisions will have on innovation in the video programming market and make a final decision that will benefit consumers and innovation alike.

If you have any questions related to this comment, please contact Jackson Eaton of the Subcommittee Staff at jackson_eaton@hsgac.senate.gov with any questions.

Sincerely,

Claire McCaskill
Ranking Member

cc: Rob Portman
Chairman
Permanent Subcommittee on Investigations
United States Senate

[59] http://www.theregister.co.uk/2014/11/17/sony_unveils_guts_of_ott_service_so_far_for_playstations_only/ and http://www.multichannel.com/blog/bauminator/sony-s-ott-tv-play-priced-sell/384493.