The Proposed Comcast-NBC Universal Combination: How It Might Affect the Video Market

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Summary

The proposed combination of Comcast, the largest distributor of video services in the United States, and NBC Universal (NBCU), a major producer and aggregator of video content, would create a huge, vertically integrated entity with potentially enormous negotiating power at a time when market forces already are altering traditional content provider/distributor relationships. Comcast would own or control media and entertainment properties of significant scope and scale.

Despite the size and reach that Comcast would be afforded, there is so much uncertainty in the video market that the proposed combination has elicited a wide range of predictions about (1) how it would affect that market; (2) how it would affect the long-standing public policy goals of competition, diversity of voices, and localism; and (3) whether the merger would prove beneficial to Comcast's shareholders.

From one perspective, the scope of the combination would be so broad that, in addition to requiring careful scrutiny of its competitive effects, it potentially could affect market structure and relationships in ways that have implications for a wide range of media rules, regulations, and policies, including program carriage rules, program access requirements, retransmission consent rules, long-standing policy supporting free over-the-air broadcast television, and even network neutrality and open access policies. From another perspective, the recent history of failed mega-mergers in the communications sector suggests that the vertically integrated post-merger entity may have so many parts with conflicting market incentives that it proves impossible to craft an internally consistent profit-maximizing business strategy, no less exploit market power to undermine competition.

There is consensus that the Department of Justice (DOJ) and the Federal Communications Commission (FCC) are likely to approve the combination subject to merger conditions and/or license conditions—intended to protect competition, diversity of voices, and localism—that may significantly affect the impact of the combination. It is possible, however, that such conditions might have the effect both of protecting the public against significant harms created by the combination and of limiting potential benefits created by the combination.

The traditional business models of just about every participant in the video market are potentially challenged by structural market changes and as a result the current environment is characterized by very contentious programmer-distributor negotiations and a multitude of novel new ways to distribute content as incumbents and new entrants experiment with new business models.

The issues likely to require the most attention of the DOJ and FCC include whether Comcast would be able to use its vertically integrated position to deny rival distributors access to programming or to raise the cost of that programming; whether Comcast would be able to use its vertically integrated position to favor the programming of NBCU at the expense of independent programmers; whether Comcast would have the incentive to use the merger to change NBC into a cable network, at the expense of local programming; and whether a combined Comcast-NBCU might have the unique ability to craft new business models that benefit consumers.

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Introduction

The proposed combination of Comcast, the largest distributor of video services in the United States, and NBC Universal (NBCU), a major producer and aggregator of video content, would create a huge, vertically integrated entity[1] with potentially enormous negotiating power at a time when market forces already are altering traditional content provider/distributor relationships. Comcast would own or control media and entertainment properties of significant scope and scale, including:

- Comcast's cable systems, which currently serve 24.2 million subscribers, making Comcast the largest provider of multichannel video programming distribution (MVPD) services in the United States;
- Comcast's broadband network, which passes more than 50 million homes and provides high speed Internet service to just under 15 million households, making Comcast the largest residential information service provider (ISP) in the United States;
- A number of national cable networks, including NBC's USA, Bravo, CNBC, MSNBC, Oxygen, and Syfy networks and Comcast's E!, Style, Golf Channel, and Versus networks, as well as minority interests in the A&E, Biography, History Channel, Weather Channel, and Lifetime cable networks, and small interests in the Big Ten, NHL, and MLB cable networks;
- Comcast's 10 regional cable sports networks;
- The NBC national broadcast television network, including NBC News (a leading source of global and national news with top-rated news programming), NBC Universal Sports and Olympics (which holds contracts to broadcast the 2010 Winter Olympics and 2012 Summer Olympics, NBC Sunday Night Football, NHL/Stanley Cup, the PGA Tour, the U.S. Open, the Ryder Cup, Wimbledon, and the Kentucky Derby), and NBC Entertainment;
- NBC's Telemundo national broadcast television network, the second-largest Spanish language programming network in the United States;
- NBC's ten owned and operated local broadcast stations, which carry the NBC network programming in large U.S. markets, including New York, Los Angeles, Chicago, and Philadelphia;

[1] Specifically, Comcast and General Electric (GE) have signed a definitive agreement to form a joint venture that will be 51% owned by Comcast, 49% owned by GE, and managed by Comcast. The joint venture will consist of the NBCU businesses (currently primarily owned by GE) and Comcast's cable networks, regional sports networks, and certain digital properties and unconsolidated investments. Comcast's cable systems will remain separate, but both the cable systems and the joint venture will be managed by Comcast. GE will be entitled to cause the joint venture to redeem one-half of GE's interest after three and a half years and the remaining interest after seven years and Comcast has certain rights to purchase GE's interest in the venture at specified times. See "Comcast and GE to Create Leading Entertainment Company," *Comcast Investor Relations*, December 3, 2009. At least one industry analyst, Jason Bazinet of Citigroup, reportedly has indicated that Comcast would have both the ability and the incentive to own 100% of the joint venture by 2014. See Mike Farrell, "Analyst: Comcast Could Own 100% of NBCU by 2014," *Multichannel News*, December 16, 2009.

- NBC's 16 owned and operated local broadcast stations, which carry the Telemundo network programming in cities with large Spanish-speaking populations, including Los Angeles, New York, Miami, Houston, Chicago, and Dallas;
- NBCU's large television production operations, which produce broadcast network programming, NBCU Television Distribution's broadcast program syndication operations, and a 3,000-title library of television episodes;
- NBCU's Universal Pictures and Focus Features, which produce theatrical and non-theatrical films, as well as Universal Studio Home Entertainment's extensive movie library with more than 4,000 titles;
- Digital media properties, including CNBC.com, iVillage, NBC.com, Fandango, and Daily Candy, which together generate more than 40 million unique users each month; and
- NBC's 30% interest in Hulu.com, a website that offers free, advertising-supported streaming video of broadcast and cable television programs.

Despite the size and reach that Comcast would be afforded if the deal is completed, there is so much uncertainty in the video market that the proposed combination has elicited a wide range of predictions about (1) how it would affect that market; (2) how it would affect the long-standing public policy goals of competition, diversity of voices, and localism; and (3) whether the merger would prove beneficial to Comcast's shareholders.

From one perspective, the scope of the combined entity would be so broad that, in addition to requiring careful scrutiny of its competitive effects, it potentially could affect market structure and relationships in ways that have implications for a wide range of media rules, regulations, and policies, including program carriage rules, program access requirements, retransmission consent rules, long-standing policy supporting free over-the-air broadcast television, and even network neutrality and open access policies. From another perspective, the recent history of failed mega-mergers in the communications sector suggests that the vertically integrated post-merger entity may have so many pieces with conflicting market incentives that it proves impossible for executives to craft an internally consistent profit-maximizing business strategy, much less exploit market power to undermine competition.

There is consensus that the Department of Justice (DOJ) and the Federal Communications Commission (FCC) are likely to approve the combination subject to merger conditions and/or license conditions—intended to protect competition, diversity of voices, and localism—that may significantly affect the impact of the combination. It is possible, however, that such conditions might have the effect both of protecting the public against significant harms created by the combination and of limiting potential benefits created by the combination.

Structural Changes in the Video Market

With or without the Comcast-NBCU combination, the video market is in a state of flux. Significant technology-induced structural changes on both the supply side and the demand side of the market are fragmenting audiences, affecting the level of revenues generated, and shifting the flow of those revenues among industry players. Long-standing business models of both content providers and distributors are being challenged. The impact of the proposed merger on the video market and on public policy goals will be affected by these dynamic forces currently at play.

Some of the structural changes are the result of independent new competitors entering the market. Others are the result of firms that already had a strong market presence expanding or extending into new activities.

On the distribution side, technological innovation has generated major new entry. In the early 1990s, when many of the regulatory rules affecting content-distributor relationships were adopted, there was little competition to cable in the MVPD market. In June 1994, fewer than two million households subscribed to satellite television service, and most of those used the C-band technology; fewer than 70,000 were served by direct broadcast satellite (DBS), which was still in its infancy.[2] Telephone companies were not offering video services at all. Cable dominated, with 59.5 million basic cable customers in 1994,[3] out of a total of 94.2 million television households.[4] Most cable subscribers had not retained their rooftop broadcast television antennas; if their cable company chose not to carry a particular local broadcast station's signal, many subscribers no longer were able to receive the broadcaster's programming (including the advertising) and had no alternative source for that programming. Since the cable company's carriage decision heavily determined the number of viewers that would view a broadcaster's programming and advertising, it enjoyed a very strong negotiating position vis-à-vis the broadcaster.

In contrast, today most American households have access to the two major DBS providers, DirecTV and Dish Network; there are more than 31 million subscribers to satellite video service. In addition, at mid-year 2009, Verizon's FiOS television service was available to 10.3 million households and purchased by 2.5 million households,[5] and AT&T's U-verse service, at the end of the third quarter of 2009, was available to approximately 20 million households and purchased by 1.8 million households.[6] The FiOS and U-verse services are not available in the same markets. Thus most households have access to at least three MVPD providers and MVPDs that fail to carry "must-have" broadcast (or other) programming that their competitors offer may find themselves at a significant competitive disadvantage. Hence broadcasters and other programmers are in a strengthened negotiating position vis-à-vis MVPDs.

At the same time, consumer electronics manufacturers have added a number of streaming video capabilities to a range of devices that allow consumers to easily connect their televisions to the Internet. Such devices include Internet-ready high definition televisions (HDTVs), DVRs, Blu-Ray DVD players, video game consoles (including Xbox 360, PlayStation 3, and Wii), and dedicated boxes (such as the $80 WiFi- or Ethernet-enabled Roku player). These devices provide access to numerous video on demand (VOD) services, including Netflix, Amazon Video,

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[2] Satellite Broadcasting & Communications Association, "Satellite Subscribers History," based on data obtained through MediaBiz: Competitive Intelligence, available at http://www.sbca.org/receiver-network/industry-satellite-facts.htm.

[3] NCTA, "Basic Video Customers, 1975-2008," based on data from SNL Kagan, available at http://www.ncta.com/Stats/BasicCableSubscribers.aspx.

[4] Television Bureau of Advertising, "Media Trends Track—TV Basics: Television Households," compiled from The Nielsen Company-NTI, September each year, and presented at http://www.tvb.org/rcentral/mediatrendstrack/tvbasics/02_TVHouseholds.asp.

[5] Reported in Stacey Higginbotham, "Is Verizon FiOS Putting the Hurt on Cable," http://gigaOM.com/2009/07/27/is-verizon-fios-putting-the-hurt-on-cable/, July 27, 2009.

[6] Reported in http://www.UverseUsers.com, October 22, 2009.

MLB.com, and YouTube. They have created an entirely new way to distribute video. The introduction of the highly mobile Apple iPad provides another alternative for consumers to watch video over the Internet through a WiFi/3G-enabled device that is considerably larger than the iPhone, Android phone, or iPod Touch. One of Apple's potential advantages is the iTunes Store, which is capable of supplying a significant amount of additional content to consumers. All of these products (including home computers and laptops) allow consumers at home and on the road to access a potentially unlimited supply of programming available over the Internet. It is not clear whether Internet-based VOD services will gain sufficient access to desirable programming—and particularly to the "must-have" programming that a significant portion of viewers require from their video service. Nevertheless, the emergence of Internet-enabled, HDTV-quality Internet service could ultimately prove to be disruptive to MVPDs and over-the-air broadcasters.

On the content side, structural changes have been fragmenting audiences for more than two decades, but just when that fragmentation seemed to be abating, new market forces have been created to continue the trend. The initial cause of audience fragmentation was the successful entry of cable networks. As these networks proliferated they also evolved from primarily offering re-run broadcast or theatrical film programming to offering substantial amounts of original programming. Today there are more than 500 cable networks, 35 of which come into more than 90 million households and another 42 that come into more than 50 million households.[7] More than 85% of all television households in the United States subscribe to MVPD service[8] and the average television household receives 130 television channels.[9]

As recently as the early 1990s, the then-three major broadcast networks (ABC, CBS, and NBC) and their affiliates commanded approximately 49% of U.S. television home set usage; today, the four major broadcast networks (with the successful entry of FOX) and their affiliates command only approximately 25%.[10] Other broadcast stations command an additional 13% of television usage. In contrast, advertising-supported cable networks commanded just 20% of television set home usage in the early 1990s, but today the several hundred advertising-supported cable networks command approximately 48% of usage, and pay cable networks an additional 4%. Many of the successful cable networks are owned in whole or in part by companies that also own a major broadcast network.

Audiences are unlikely to be further fragmented by additional cable network entry. There does not appear to be consumer demand for additional program offerings over yet more cable networks.[11] Rather, a growing number of consumers, especially younger viewers, want to be able to watch popular programming at a time and place that is convenient for them. Instead of a fixed, linear schedule of programming, they are time-shifting their viewing through the use of DVRs and video on demand (VOD) offerings. They also are location-shifting, through video streaming and other Internet-based video services, game consoles, and mobile video. These alternatives are still

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[7] SNL Kagan, *Broadband Cable Financial Databook*, 2009 edition, "Census of Basic Cable TV Services (Mil.)," at pp. 14-17.

[8] Based on data from "Pay TV Subscriber History" in SNL Kagan, *Broadband Cable Financial Databook, 2009*, at p. 9.

[9] "Stations and Channels Receivable Per TV Household," in Nielsen Company, *Television Audience Report 2008*, downloadable from http://blog.nielsen.com/nielsenwire/media_entertainment/more-than-half-the-homes-in-us-have-three-or-more-tvs/.

[10] Media Dynamics, Inc. *TV Dimensions 2006,* Annual Report.

[11] In 2009 (admittedly a particularly harsh economic year) there were only two major new network launches, Retirement Living TV and the MLB. See SNL Kagan, *Broadband Cable Financial* Databook, 2009 edition, at p. 6.

in their infancy and it is not clear which will grow (and by how much) at the expense of traditional broadcast and cable networks. But they have become significant enough that Nielsen Research has begun to prepare quarterly reports on "Three Screen" video viewing—television, computer, and cellphone. According to a recent Nielsen report:[12]

- The 292 million people in the United States with a television on average each week spend 31 hours and 35 minutes watching traditional television, but just 32 minutes watching time shifted television. They spend 4 hours and 6 minutes using the Internet, but only 22 minutes of that time watching video on the Internet, and just 3 minutes watching video on a mobile phone. Thus, time shifted television watching, Internet video watching, and mobile phone video watching still represent a very small portion of total video watching.
- But alternative forms of video watching are growing faster than overall video watching. The number of people who time shifted increased by 26.9% from 3Q08 to 3Q09. In that same period, the number of people who watched video on the Internet increased by 14.8% and the number of people who watched video on a mobile phone increased by 53%. On a monthly basis, the 47% of the population (138 million people) who watch video on the Internet spend on average 3 hours and 24 minutes during the month doing so; the 5% of the population (15.7 million people) who watch mobile video in the United States spend on average 3 hours and 15 minutes during the month watching video on a mobile phone.

These new time- and location-shifting means of receiving video further fragment video audiences. When a particular program is offered—and viewed—over multiple platforms, it may be possible to add up the total audience for that program, but the market impact will not be the same as if that aggregate audience was all viewing the program over a single platform. Viewers may be valued differently by advertisers depending on the platform used to view the programming; some platforms can be more readily employed than others to generate per viewer fees; and the multiple platforms will be competing with one another and thus the sum of their negotiating strength in the market will be lower than that of a platform provider with the full audience.

Nielsen has begun measuring time-delayed as well as traditional television viewing,[13] and some industry players are pressing Nielsen to speed up its efforts to construct cross-platform ratings.[14] But there is evidence that the audience for time-shifted programming is qualitatively different in that it is likely to view fewer advertisements.[15] If identical programming generates less revenue from newly fragmented portions of the audience, then the fragmentation will have a real financial

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[12] The Nielsen Company, "A2/M2 Three Screen Report," Volume 6, 3rd Quarter 2009, updated December 18, 2009.

[13] See Brian Steinberg, "Nielsen Reverses Decision to Drop Live Local TV Ratings," *Advertising Age*, December 16, 2009.

[14] See Kevin Downey, "TV Pushes Cross-Platform Ratings in '10," *TVNewsCheck,* December 23, 2009, available at http://www.tvnewscheck.com/articles/2009/12/23/daily.4/. See also Brian Stelter, "Nielsen to Add Online Views to its Ratings," *New York Times,* December 2, 2009.

[15] See, for example, Diego Vasquez, "Fact is, far fewer see ads in DVR'd shows," Media Life Research, January 8, 2010, available at http://www.medialifemagazine.com/artman2/publish/Research_25/Fact_is_far_fewer_see_ads_in_DVR_d_shows.asp. See also, Brian Steinberg, "Nielsen Reverses Decision to Drop Live Local TV Ratings," *Advertising Age*, December 16, 2009, in which it is explained that media buyers were up in arms when Nielsen intended to provide only a single aggregate figure for live viewership and time shifted viewership, rather than disaggregating the two, arguing that users of DVRs are lower-valued because they skip past advertising.

impact on programmers as well as distributors. For example, the proliferation of Internet sites—both those offering video services and others—has created a huge supply of potential online advertising sites and as a result has tended to depress the rates for advertising on the Internet.[16] To the extent consumers shift from traditional television viewing to non-traditional viewing, and the latter generates lower advertising (or subscription) revenues per viewer, this audience fragmentation will reduce the profitability of the existing business models employed by network providers and MVPDs, alike. There is one countervailing market force, however. It appears that increasing the number of platforms over which video (television and film) programming is available increases the total number of minutes of viewing, and thus partially constrains the fall in revenues.

Changes in Traditional Video Business Models

The traditional business models of just about every participant in the video market are potentially challenged by these structural market changes and as a result the current environment is characterized by very contentious programmer-distributor negotiations and a multitude of novel new ways to distribute content as participants experiment with new business models.

Broadcast Networks and Their Affiliated Local Broadcast Stations

The broadcast television industry (both broadcast networks and their affiliated local broadcast stations) has long relied on a business model with a single primary source of revenues—advertising. The networks put together a schedule of national network programming, with certain hours set aside for local programming. Some number of minutes per hour of the national network schedule are set aside for national advertising, which generates revenues for the network, and additional minutes per hour are set aside for local advertising, which generates revenues for the local station. In addition, the local station generates advertising revenues from ads placed in the local programming portion of the schedule. When the broadcast signal is carried by an MVPD that serves the broadcast station's market, the local station and its broadcast network indirectly benefit because they can include the MVPD subscribers who view that station in their audience share when setting their advertising rates. Since MVPD subscribers often do not have rooftop antennas to receive high quality local broadcast signals over-the-air, if an MVPD did not carry a local broadcast station's signals, subscribers would be less likely to view that station's programming.

The Cable Television Consumer Protection and Competition Act of 1992,[17] enacted in part to constrain the negotiating power enjoyed by cable systems (most of which faced no competition in the MVPD market at that time), in effect established a new property right for broadcast stations by setting carriage and compensation requirements for cable systems (later extended to satellite systems as well) for the retransmission of local broadcast station signals that were otherwise available free over-the-air. These statutory rules created a potential new source of revenues for broadcasters. Every three years, each local commercial broadcast station must choose between (1) negotiating a retransmission consent agreement with each cable system operating in its service

[16] See CRS Report R40908, *Advertising Industry in the Digital Age*, by Suzanne M. Kirchhoff.

[17] P.L. 102-385. These new rules were placed into sections 325 and 614 of the Communications Act, as amended (47 U.S.C. §§ 325 and 534).

area, whereby if agreement is reached the broadcaster is compensated by the cable system for the right to carry the broadcast signal, and if agreement is not reached the cable system is not allowed to carry the signal; or (2) requiring each cable system operating in its service area to carry its signal, but receiving no compensation for such carriage. The latter option is frequently chosen by small independent television stations with relatively small audiences that might otherwise not be carried by the MVPDs in their market. But since both network programming and local news and sports programming tend to be highly valued by television viewers, virtually all local network affiliates choose the "retransmission consent" option, rather than the "must carry" option, and demand compensation from MVPDs for carriage of their programming.

From 1992 through 2005, the compensation that local network affiliates received for retransmission consent rarely took the form of cash payments from MVPDs. Rather, in most cases, the local affiliate gave its network the right to negotiate retransmission consent directly with the MVPDs; in exchange, the affiliate station made lower cash payments to its network for the network programming (or, in some cases, received cash payments from the network). Each of those networks (ABC, CBS, FOX, and NBC) are subsidiaries of large producers and aggregators of video programming, which own multiple cable networks as well as their broadcast network. During this period, these large programmers tended to follow a two-fold business plan: (1) to get the widest possible carriage of their cable networks by MVPDs, and (2) to use their brand identity (ESPN, Disney, FOX, etc.) to create—and get MVPD carriage of—additional cable networks with slightly different target audiences. To further their corporate parents' business plan, the broadcast networks, rather than seeking cash payments from MVPDs, sought compensation in the form of MVPD carriage of these cable networks.

Starting in 2005, some local broadcast stations (and one broadcast network, CBS, on behalf of its owned and operated affiliate stations) began to seek cash retransmission consent compensation,[18] motivated by four market developments. First, the parent companies of the broadcast networks largely had attained their business goal of creating a number of branded cable networks with very high levels of household penetration. Many of their cable networks were carried by most of the large MVPDs, with aggregate household penetration of more than 80 million households,[19] and no longer required the leverage from retransmission consent negotiations to retain that carriage. Other forms of compensation, such as cash, became more attractive.

Second, starting with the dot.com recession of 2001 and continuing through the decade (especially in 2008), it became clear that advertising revenues were increasingly sensitive to the economic business cycle and (more recently) were stagnant or falling due to structural changes in the broadcast market. As shown in **Table 1**, broadcast television advertising revenues were becoming increasingly dependent on the alternate year in-flows from the Olympics and political campaigns, and while they were growing through 2008, their declining rate of growth reflected the defection of audiences to cable networks. In the current economic downturn, broadcast revenues have actually fallen substantially and due to structural changes in the market are not projected to rebound. As a result, broadcasters have a strong incentive to seek non-advertising revenues.

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[18] For a discussion of these changes in retransmission consent compensation, se CRS Report RL34078, *Retransmission Consent and Other Federal Rules Affecting Programmer-Distributor Negotiations: Issues for Congress*, by Charles B. Goldfarb.

[19] SNL Kagan, *Broadband Cable Financial Databook*, 2009 Edition, "Census of Basic Cable TV Services (Mil.)," at pp. 14-17.

Table 1. Television Advertising Expenditure Components

(millions of dollars)

Year	Network Broadcast Television	Network Broadcast – Olympics	Local Broadcast Television	Local Broadcast – Political	National Syndication	National Cable Television	Local Cable Television
1998	11,474.6	485.7	13,750.6	648.6	2,049.7	7,227.1	1890.5
1999	12,367.7	0.0	15,232.8	79.1	2,098.4	8,804.6	2,298.3
2000	13,582.6	785.0	16,351.7	676.0	2,162.0	9,660.3	2,491.0
2001	13,345.0	0.0	15,012.6	151.6	2,070.6	9,870.6	2,756.7
2002	14,113.0	606.1	15,808.4	911.5	1,643.6	11,191.8	3,055.0
2003	14,404.9	0.0	16,729.1	169.3	1,951.8	12,475.6	2,869.5
2004	15,143.4	704.3	16,192.1	1,504.5	2,233.5	13,840.7	3,101.2
2005	15,529.1	0.0	17,484.9	424.4	2,152.0	15,290.8	3,321.6
2006	15,501.9	650.0	16,169.9	2,100.0	1,969.3	15,971.9	3,346.2
2007	15,515.2	0.0	17,614.5	677.3	1,974.2	17,053.0	3,713.2
2008	14,676.9	600.0	14,817.4	2,000.0	1,934.8	17,885.7	3,337.1
2009 est.	13,334.0	0.0	11,751.3	911.6	1,792.4	17,186.9	2,787.4
2010 est.	12,998.6	487.5	11,499.2	2,390.3	1,672.2	18,050.0	2,914.9
2011 est.	12,889.1	0.0	11,616.7	1,241.5	1,636.8	19,148.4	3,036.5
2012 est.	12,775.1	621.7	11,763.1	2,591.4	1,599.4	20,316.1	3,169.0
2013 est.	12,655.8	0.0	11,939.8	1,499.4	1,560.0	21,559.6	3,313.4
2014 est.	12,579.4	498.9	12,195.5	2,664.7	1,524.2	22,975.6	3,484.5

Source: Television Bureau of Advertising, Media Trends Track, "TV Basics: Television Ad Expenditure Components," based on data from Magna Global, available at http://www.tvb.org/nav/build_frameset.aspx, then go to "research central," then to "media trends track." then to "TV basics," then to "TV ad expenditure components," viewed on January 21, 2010. The National Broadcast Television and National Cable Television data exclude online advertising revenues; the Network Broadcast Olympics data exclude incremental Olympics advertising revenues; the Local Cable Television data exclude local political advertising revenues.

Third, the advertising-supported cable networks were flourishing from their business model that included both advertising revenues and per subscriber license fees charged to MVPDs for carrying the network programming. As shown in **Table 2**, beginning in 2001, subscriber fees became a larger source of revenues for these cable networks than advertising. Broadcasters had every incentive to emulate the cable networks' two-revenue-source business model. Broadcast network programming, and even certain local broadcast station programs, continued to attract significantly larger audiences than cable network programming. According to a Television Bureau of Advertising tabulation of Nielsen ratings data, excluding the programming on premium (non-advertising supported) cable channels such as HBO and Showtime, the 255 individual television programs with the largest audience ratings in the 2005-2006 television season all were broadcast programs; only 10 of the 586 highest-rated programs were cable programs.[20] For the most

[20] Television Bureau of Advertising, Ratings Track, "Full Season Broadcast vs. Subscription TV Primetime Ratings: 2005-2006," based on data from Nielsen Media Research, Galaxy Explorer, Primetime Viewing Sources Report, available at http://www.tvb.org/nav/build_frameset.aspx, then go to "research central," then to "ratings track," then to "prior seasons archives," then to "2005-2006 season."

recently completed season, 2008-2009, the highest rated advertising-supported cable show ranked number 80, the second-highest rated ranked number 103, and the third ranked number 195.[21] Moreover, there was market evidence that viewers valued the programming of local broadcast stations and were willing to pay for it. When satellite carriers were first allowed to retransmit the signals of local broadcast stations, they typically offered their subscribers these signals for an additional fee of $5 per month, and take rates were quite high.

Table 2. Advertising-Supported Cable Network Revenue Mix, 1989-2008

(billions of dollars)

Year	Total Revenues	Net Advertising	License Fees	Other
1989	$2.2	$1.2	$1.0	$0.0
1990	$3.0	$1.6	$1.4	$0.1
1991	$3.6	$1.8	$1.6	$0.1
1992	$4.2	$2.1	$1.9	$0.2
1993	$4.8	$2.4	$2.2	$0.2
1994	$5.6	$2.8	$2.5	$0.2
1995	$6.7	$3.4	$3.0	$0.3
1996	$8.1	$4.2	$3.6	$0.4
1997	$9.9	$5.0	$4.4	$0.4
1998	$12.0	$6.2	$5.3	$0.5
1999	$14.5	$7.6	$6.2	$0.7
2000	$17.0	$8.9	$7.5	$0.7
2001	$18.4	$8.8	$8.9	$0.7
2002	$20.5	$9.2	$10.5	$0.7
2003	$24.1	$10.8	$12.4	$0.9
2004	$27.4	12.1	$14.4	$0.9
2005	$31.1	$13.9	$16.0	$1.1
2006	$34.5	$15.2	$18.0	$1.4
2007	$38.6	$16.6	$20.4	$1.6
2008	$42.2	$17.8	$22.8	$1.6

Source: SNL Kagan, *Economics of Basic Cable Networks,* 2009 Edition, at p. 2.

Fourth, with the successful competitive entry of two satellite providers and the announced plans of Verizon and AT&T to begin offering video service, cable operators began to face competition in the MVPD market. When negotiating retransmission consent agreements, broadcasters with must-have programming, especially sports programming, were in a much stronger negotiating position since any MVPD that failed to reach agreement with the broadcaster, and therefore could

[21] Television Bureau of Advertising, Ratings Track, "Top-rated programs of 2008-09 in Households," based on data from Nielsen Galaxy Lightning estimates (Live and Same Day), 9/22/08-5/20/09, available at http://www.tvb.org/nav/build_frameset.aspx, then go to "research central," then to "ratings track," then to "prior seasons archives," then to "2008-2009 season."

not carry the broadcaster's programming, risked losing subscribers to competitors who did carry that must-have programming. In particular, the new entrants—primarily Verizon and AT&T, but also to some extent the satellite operators—felt a strong need to carry as much programming as possible to attract subscribers and were willing to pay cash for broadcast programming as a cost of offering the triple play of video, telephone, and Internet access service. Once one MVPD agreed to make cash payments for retransmission consent, it became easier for broadcasters to demand similar payments of the other MVPDs. Thus, changing market forces are providing broadcasters with the ability, as well as the incentive, to demand per subscriber cash license fee payments.

The MVPDs, to varying degrees, have resisted broadcaster attempts to impose these cash payments. In 2005-2007, there were publicly contentious retransmission consent negotiations—some of which resulted in impasses, with MVPD subscribers losing access to certain programming for as long as several months. These negotiations involved, among others, Nexstar and Cox, CBS and several large cable operators, DISH Network and Hearst-Argyle/Lifetime, Sinclair and Mediacom, and Sinclair and Suddenlink.[22] Recently, contentious negotiations between FOX and Time Warner Cable and between Sinclair and Mediacom have played out in the press, and induced Members of Congress, the FCC, and state legislators to beseech the parties to reach an agreement, before being resolved either at the last minute or after a very short extension beyond the expiring contract date.

In December 2009, the major MVPDs submitted to the FCC a study that they commissioned of the current retransmission consent regime.[23] It provided estimates made by SNL Kagan (Kagan), a data collection and analysis company whose data are widely used by the industry, of cash retransmission consent fees. These estimates are reproduced in **Table 3**. Note that the DBS providers were quicker to make cash payments than the cable operators, but Kagan projects a much faster rise in future cash payments by the cable operators. It is interesting that these estimates, made in midyear 2009, now appear to be low, based on the demands that FOX was making in its recent negotiations with Time Warner Cable and the statements of other major networks that they would seek cash payments similar to those received by FOX in their future retransmission agreements. In its negotiations, FOX was seeking $1 per month per Time Warner subscriber. Although the terms of the agreement were not made public, many industry observers believe that FOX will initially receive approximately $0.50 per month per Time Warner Cable subscriber, but that rate will escalate over several years to $0.75.[24] Assuming that each of the four major networks was able to get that same level of payment,[25] that would initially generate retransmission consent fees of $2.00 per month, or $24.00 per year per household. For the

[22] For a discussion of these contentious negotiations, see CRS Report RL34078, *Retransmission Consent and Other Federal Rules Affecting Programmer-Distributor Negotiations: Issues for Congress*, by Charles B. Goldfarb.

[23] Michael L. Katz, Jonathan Orszag, and Theresa Sullivan, *An Economic Analysis of Consumer Harm from the Current Retransmission Consent Regime*, commissioned by the National Cable & Telecommunications Association, DirecTV, and DISH Network, and submitted on December 16, 2009, to the Federal Communications Commission in MB Docket No. 07-269, Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, and in response to NBP Public Notice #26, GN Docket Nos. 09-47, 09-51, 09-137 (A National Broadband Plan for Our Future).

[24] See, for example, Claire Atkinson, "Cable Nets Gird for Carriage Crisis: Broadcasters' push for retrans cash may hurt smaller players," *Broadcasting & Cable*, January 9, 2010.

[25] This might be an overstatement to the extent that FOX currently has higher rated programming than all networks except CBS, but might be an understatement to the extent that broadcasters could negotiate even higher rates from smaller MVPDs.

approximately 100 million households that subscribe to MVPD service, that would amount to $2.4 billion per year. When the fee increases to $0.75, it would generate $3.6 billion per year in revenues. Even the lower figure is significantly higher than the Kagan estimate. Given that Kagan has estimated that in 2010 there will be 13 advertising-supported cable networks with average monthly license revenue fees of $0.50 or more (ranging up to $4.41 for ESPN),[26] and none of these cable networks attract audiences anywhere near as large as the four broadcast networks do, an assumption of per subscriber license fees of $0.50-$0.75 per broadcast network per month may be conservative.

Table 3. Estimated Cash Retransmission Consent Fees, 2006-2015, by MVPD Type

(millions of dollars)

Year	Cable	DBS	Telco	Total
2006	$44.3	$168.7	$1.6	$214.6
2007	$86.0	$216.6	$10.9	$313.5
2008	$188.9	$277.7	$33.5	$500.1
2009	$315.2	$352.1	$71.4	$738.7
2010	$424.0	$390.0	$119.1	$933.1
2011	$573.8	$425.9	$161.3	$1,161.0
2012	$639.6	$451.3	$192.6	$1,283.5
2013	$709.4	$467.7	$220.3	$1,397.4
2014	$835.8	$484.7	$245.0	$1565.5
2015	$861.9	$500.7	$267.4	$1,630.0

Source: Michael L. Katz, Jonathan Orszag, and Theresa Sullivan, *An Economics Analysis of Consumer Harm from the Current Retransmission Consent Regime*, using data from SNL Kagan, "Broadcast retrans fees on track to break $1 bil. by 2011," *Broadcast Investor: Deals & Finance*, June 30, 2009.

In reviewing these estimates, it is best to focus on the trend and not on the exact numbers, however, because in practice these retransmission consent agreements cover many variables and it is not possible to separate out per subscriber cash payments from other compensation. Typically, the give and take of negotiations yields a single overall payment to the broadcaster, but that single payment represents an amalgam of parameters. Even if the broadcaster is a pure broadcast player, without cable networks, its payment from the MVPD will cover, among other items, (1) the right to retransmit the broadcaster's signal during the scheduled viewing of the program; (2) the right to offer some portion of the broadcast programming as part of the MVPD's video on demand service; (3) a certain amount of MVPD advertising on the broadcast station; (4) the channel placement of the broadcaster's signal on the MVPD tier; and (5) carriage of the broadcaster's multicast sub-channels (which could require a payment by the broadcaster for carriage or payment to the broadcaster, depending on perceived demand for the programming on the sub-channel). By consolidating all of these into a single payment, when a broadcaster and an MVPD report their costs and revenues to the Securities and Exchange Commission, they have the flexibility (and perhaps the incentive) to attribute the retransmission consent cash payment differently. The networks will have the incentive to attribute as much of the total retransmission

[26] SNL Kagan, *The Economics of Basic Cable Networks*, 2009 Edition, at p. 53.

payment as possible as cash payment, since this might help them obtain higher cash payments in future negotiations with other MVPDs; the MVPDs will have the opposite incentive.

There is another dimension to the changing business model concerning retransmission consent—the portion of these revenues that flow to the local broadcast stations (the entities that, by law, have the right to seek retransmission compensation from MVPDs) and the portion that flows to the broadcast networks. As local stations have negotiated large increases in cash compensation from MVPDs, their networks have sought to get a share. ABC was reported to be seeking half of its affiliates' retransmission consent revenues.[27] If the networks demand a portion of these revenues, that places greater pressure on the local stations to push for higher cash payments from MVPDs. Most observers believe that the broadcast networks and their local station affiliates will come to some agreement on how to apportion these revenues since they enjoy a symbiotic relationship that benefits both and both contribute to the must-have programming that MVPDs need—the highly demanded national news, entertainment, and sports programming and the highly demanded local news, weather, and sports programming.

The business relationship between MVPDs, broadcast networks, and their local station affiliates may change in yet another way. With the deployment of digital technology, local broadcast stations now can—and do—broadcast multiple video streams. Many stations already are broadcasting their primary video stream in high definition and one or more secondary video streams in standard definition. But since 85% of all households subscribe to MVPDs and typically do not have rooftop antennas, many if not most households do not receive high quality broadcast signals over-the-air, relying instead on their MVPD to carry the local broadcast signals. The must carry requirement in the Communications Act[28] is limited to the "primary video," however, and therefore local stations must negotiate carriage of their non-primary signals with the MVPDs serving their market. This typically occurs as yet another factor in the retransmission consent negotiations for the primary video stream. Local stations may choose to obtain less cash from MVPDs in exchange for the MVPDs carrying their non-primary signals. The major networks with whom they are affiliated for programming on their primary video stream may prefer to maximize cash retransmission payments.

Local stations must make decisions about what type of programming they broadcast over their non-primary video streams. Although there have been some exploratory efforts by the broadcast networks and their local affiliates to jointly create programming for these non-primary signals, network-affiliate ventures have focused more on how to jointly use national and local programming effectively on their websites.[29] Alternatively, local stations can carry the programming of existing broadcast networks that don't have a local affiliate in the market (such as CW or My Network Television Networks) and more than a dozen start-up broadcast networks seek carriage of their syndicated programming (much of it re-run television programming and old movies) on local stations' non-primary signals.[30] Some industry observers have argued that the

[27] Linda Moss, "ABC Seeks Half of Affiliates' Retrans Take," *TVNewsCheck*, January 6, 2010. See also Mike Farrell, "Retrans Cost on the Rise: Networks Now Looking for a Share of Affiliates' Take," *Multichannel News*, October 10, 2009.

[28] 47 U.S.C. § 534(b)(3)(A).

[29] See Anne Becker and Allison Romano, "NBC U Starts Broadband Business," *Broadcasting & Cable*, September 18, 2006, for an early example.

[30] See, for example, Kevin Downey, "TV Works to Grow Diginet Revenue," *TVNewsCheck*, January 13, 2010, available at http://www.tvnewscheck.com/articles/2010/01/13/daily.3/.

best way for local broadcast stations to remain viable is to focus on unique local programming,[31] and perhaps to maintain a non-primary channel that has primarily local content. But such programming is expensive to produce and many local stations can barely afford to maintain the current level of local programming on their primary signals.

There is one additional market dynamic pushing the broadcasters to seek a per subscriber license fee. Historically, even as their audience has been diverted to cable programming, the broadcasters have maintained their position as providers of programming appealing to mass audiences. The programming for which consumer demand is both broadest and most intense is major sports programming. Broadcasters have been willing to pay very high rates for exclusive rights to broadcast the key sporting events of professional and university sports leagues, major tennis and golf tournaments, and the summer and winter Olympic Games. Recently, the bids have been so high that the winning network has not necessarily been able to recover its costs from the advertising revenues generated, even including advertising generated by the broadcaster's website coverage and other tie-ins.[32] The broadcasters, however, have been able to use their exclusive carriage of these live sports events to market their other programming. To the extent that the decline in advertising revenues is structural, and unlikely to recover, rather than cyclical, broadcasters may find it more difficult to bid against cable sports networks, such as ESPN or FOX Sports, for the rights to these events. On the other hand, by successfully obtaining those rights, broadcast networks gain exclusive access to must-have programming that they can use to boost their position in retransmission negotiations.

The Large MVPDs, the Large Programmers, and TV Everywhere

Based on revenues, the business model long employed by the cable operators (and largely followed by the satellite operators and telephone companies when they entered the MVPD market) continues to be robust. Kagan projects continued, if slower, growth, as total subscriptions no longer increase, but revenues per subscriber do. The revenues of multi-system cable operators grew from $31.1 billion in 1998 to $85.3 billion in 2008, and are forecast to grow at an annual rate of 4% to $128.6 billion in 2019.[33] Kagan projects that much of the continued growth will come from video services, with the greatest growth in high definition, DVR, and interactive services, which also enjoy higher profit margins than the other cable services. It expects the proportion of residential cable revenues attributable to high speed data, home networking, and telephony to fall from 31.8% of total cable residential revenues in 2009 to 28.4% in 2019. On one hand, Kagan presents optimistic projections and forecasts that capital expenditures will decrease and free cash flow will rise. On the other hand, Kagan states that "investors have not shown overwhelming support for the sector due to the competitive environment and projections for slowly declining basic sub[scription]s," which are projected to fall from 63.2 million in year-end 2009 to 60.7 million by 2019.[34] It is the perception of the investor community that the MVPD business model is starting to be challenged by competitive entry and by changes in how households are demanding video services.

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[31] See, for example, Mark K. Miller, "Stations Seen Winning with Localism," *TVNewsCheck*, January 19, 2010, available at http://www.tvnewscheck.com/articles/2010/01/19/daily.5/.

[32] See, for example, "NBC more optimistic about Olympics ad sales," *Radio Business Report/Television Business Report*, January 18, 2010, which reports that NBC will lose $200 million for the carriage of the 2010 Winter Olympics.

[33] SNL Kagan, *Broadband Cable Financial Databook*, 2009 Edition, at pp. 7-8.

[34] Ibid, at p. 5.

For many years, the MVPDs have required subscribers to purchase a large bundle of program networks made available as tiers, in part because consumer demand for these large tiers tends to be relatively price inelastic (insensitive to changes in price) and in part because these tiers facilitate the cross-marketing of program networks, which benefited both those large MVPDs and those large programmers that had financial interests in multiple branded cable networks.[35] They resisted making program networks available on an a la carte basis, with certain exceptions. One exception was for specialty programming that appealed to small audiences with very intense demand that was even less price sensitive than that for a bundle of program networks. For example, foreign language networks and certain sports programming were more profitably sold separately on small specialty tiers, such as a Korean or Chinese language tier. A second exception was edgy programming that included language or sexual content that might be offensive to some portion of subscribers and thus was offered on premium subscription channels, such as HBO and ShowTime. But even in those cases households had to subscribe to a large tier to be eligible to purchase the smaller specialty tier or premium channels.

As the demand for time shifting became more evident, MVPDs responded by increasing the portion of their capacity used for video on demand offerings, many of which were made available on a pay per view or other payment basis, though some were made available for free. But, again, these VOD offerings are only available to households that also subscribe to a large tier. The shift toward greater VOD offerings is perceived by some as a two-edged sword, however, because while it may increase total revenues or at least reduce disconnects (by providing an alternative to DVDs and Internet video streaming), it potentially undermines the long-standing business model of offering linear program schedules and demonstrates that MVPDs have the wherewithal to do a la carte pricing.

The MVPDs do face several threats, if not to the viability of their business model, then to their current profitability. As competition has developed in the MVPD market, programmers—cable networks as well as broadcast networks—have enjoyed a stronger negotiating position and have been able to increase their per subscriber license fees. Just as there have been contentious retransmission consent negotiations between broadcasters and MVPDs that have escalated to the public’s attention, and sometimes resulted in a broadcast station’s programming being pulled from an MVPD’s service offering, so have there been contentious negotiations between cable networks and MVPDs, some of which have resulted in impasses with programming pulled. For example, as a result of an impasse between Scripps Networks Interactive Inc. and Cablevision Systems Corp. over fees for HGTV and the Food Network, 3.1 million Cablevision subscribers in the metropolitan New York area lost access to those networks in January 2010. The per subscriber license fee revenues generated by advertising-supported cable networks increased from $10.5 billion in 2002 to $22.8 billion in 2008 and Kagan projects they will grow to $45.4 billion in 2018.[36] Given the negotiating strength of programmers with must-have programming, a significant portion of these license fees will flow to a small number of sports networks, notably ESPN, FOX Sports, the NFL Network, and the MLB Network.

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[35] Large tiers that bundled multiple program networks also provided new independent networks with a somewhat less burdensome way to inform subscribers of their existence—partly through subscriber channel surfing and partly by paying for advertising on other networks carried on the same tier—than a pure a la carte system would, though in both cases the most difficult task of an independent programming network is to obtain carriage by the MVPD in the first place.

[36] SNL Kagan, *Economics of Basic Cable Networks*, 2009 Edition, at pp. 16-17.

Interestingly, it is possible that these increases in per subscriber fees for both cable networks and broadcast networks could lead MVPDs to reconsider their long-standing large tier business model and instead offer smaller tiers or a la carte pricing. A recent "analysis" piece by Yinka Adegoke of Reuters[37] cited comments by Cablevision Systems Corp. Chief Executive Jim Dolan that the traditional television bundle has become outdated and "inefficient" and by Time Warner Cable chief executive Glenn Britt that the prospect of rising program costs might result in cable companies offering "smaller packages." Presumably, a shift to small tiers would be motivated by the desire to decrease payments to program networks.

But recent cable industry experience negotiating for the carriage of must-have programming suggests that it may be difficult to limit fee payments for such programming. In 2008-2009, the National Football League launched the NFL Network, which offered eight regular season NFL football games, but otherwise did not have programming that might be categorized as must-have. To maximize its total subscriber fee revenues, the NFL sought carriage by MVPDs year-round on their expanded basic tier, that is the tier with the largest number of subscribers. The major cable companies resisted, insisting that they carry the network on premium sports tiers, at a higher price per subscriber, but limited to those subscribers who purchase the sports tier and who (if they primarily are football fans) might cancel the NFL Network subscription at the end of the football season. After contentious negotiations and some lawsuits, the cable companies now carry the NFL Network on their largest tiers (although likely at a lower per subscriber fee than the NFL had originally sought). Presumably, the MVPDs were forced to concede because they needed access to the eight games on the NFL Network, or because of concern that an impasse could harm future access to other must-have NFL programming. Thus, it would appear that even if the MVPDs reduce the size of their tiers, they are likely to feel compelled to offer must-have programming on the basic tier with the largest number of subscribers rather than on a specialized tier, if to do otherwise would place them at risk of losing subscribers to competing MVPDs.

The more likely impact of MVPDs moving to smaller tiers is that they would simply discontinue carrying less popular programming networks on their tiers, placing great pressure on those networks to soften their demands for subscriber fees. The MVPDs might make those niche networks available as a la carte offerings, if enough subscribers had sufficiently intense demand to be willing to pay a high monthly a la carte fee for the programming, or as VOD offerings, or they might drop them entirely.

The MVPDs and investors appear to be concerned about (1) the demand shift away from fixed, linear scheduled programming toward programming on demand, unconstrained by time or location; (2) the potential ability of new technologies capable of offering "over the top" television services to meet this demand more effectively than the MVPDs; and (3) how the major programmers will respond to the shift in demand and entry of over the top service providers. Although, as discussed above, time shifting and location shifting still represent a small portion of total video viewing, those changes are occurring largely among younger viewers who are most highly prized by advertisers and who may never develop loyalty to a linear schedule of programming. The large programmers and the large MVPDs have substantial commonality of interests, but the programmers may seek to respond to shifts in demand in ways that are not equally favorable to MVPDs.

[37] Yinka Adegoke, "Cable fee battles point to smaller TV bundles," *Reuters News Article,* January 12, 2010.

The major programmers have every incentive to seek to forestall major changes to their current business model. Kagan analyzed the 175 top cable networks and found that 19 had cash flow margins above 50%, another 31 were in the 40%-50% range, and the average cash flow margin for all 175 networks was 36.9%.[38] Kagan projected that in 2013 50% of the networks will have a margin in excess of 40% and another 28% would have margins between 30% and 40%; about 6% will have margins below 10%, primarily independent networks having difficulty gaining distribution. Given the current pattern of increasing per subscriber charges, and less interest on the part of large programmers to continue to proliferate branded cable networks, these gains are possible even when production costs are rising.

It should not be surprising that mature programming networks that have achieved high household penetration would enjoy high cash flow margins. What is significant now is that MVPDs do not appear to seek to further proliferate branded networks, entry of independent programming networks is very difficult, and therefore cash flow margins can be expected to remain high unless there is a major shift in the industry that results in falling MVPD subscriptions.

Mindful of that, programmers will feel compelled to respond to changes in demand, especially if over the top services appear to be able to better meet that demand than conventional MVPD services can. Still, these programmers are likely to proceed with an eye on simultaneously capturing potential new video audiences and minimizing the defection of revenue-generating MVPD subscribers.

In that regard, the programmers are experimenting with a number of different distribution channels and business models (for example, subscription vs. advertising-supported), forging non-exclusive relationships with both incumbent MVPDs and with new distribution service providers. These include:

- Hulu.com, a website owned by NBC, FOX, and ABC, that offers advertising-supported streaming video of television shows and movies, largely from those three programming companies but also from other networks and studios. Hulu also provides web syndication services for other websites, including AOL, MSN, MySpace, Comcast's fancast.com, and Facebook. None of the programmers that supply Hulu make all of their programming available to Hulu; nor do they make their programming available exclusively to Hulu. One of the attractions of Hulu is that it has fewer commercials than cable networks and these commercials are clustered. Hulu is available only to users in the United States. In November 2009, Hulu was reported to have 43.7 million users who streamed 923.8 million videos. Hulu's owners have suggested that they might consider adding user fees to supplement its current advertising revenue base.
- Netflix offers unlimited VC-1 video streaming to subscribers as part of its flat rate DVD and Blu-ray disc rental-by-mail service. There currently are more than 17,000 movies and recorded television shows available as part of the "Watch Instantly" video streaming service, out of the total Netflix library of more than 100,000 titles. Netflix has about 10 million subscribers, though most subscribers probably do not stream video. Videos can be played back on the subscriber's PC or Mac monitor or can be shown directly on televisions using various set-top boxes, some DVD players, or any of the three major video game consoles—

[38] SNL Kagan, *Economics of Basic Cable Networks*, 2009 Edition, at p. 5.

Microsoft's Xbox 360, Sony's PlayStation 3, or Nintendo's Wii. Netflix offers programming from NBCU, MGM, 20th Century Fox, CBS/Paramount, ABC/Disney, Warner Brothers, Lions Gate Entertainment, New Line Cinema, and Starz Entertainment, among others, but these programmers do not make all of their programming available to Netflix for streaming, nor does Netflix have exclusive access to the programming.

- Sezmi, a subscription service that offers all of a local market's broadcast television signals, including DTV multicast channels, certain interactive promotions, 23 cable networks, and 20,000 on-demand movies and television shows. This service is intended to offer a low-price alternative to traditional MVPD service. When its pilot was launched in Los Angeles in November 2009, 10,000 customers signed up in the first two days. National Association of Broadcasters executives have cited Sezmi as an example of innovating with television spectrum.[39] Again, programmers do not make all their programming available to Sezmi, nor does Sezmi have exclusive access to the programming.
- TV Everywhere, an authentication system, developed by Comcast and Time Warner, that allows individuals who subscribe to an MVPD service to access the same level of service on demand via the Internet (and, eventually, via cellphone), for no extra charge. Thus, for example, a household that does not subscribe to a premium network, such as HBO, as part of its current MVPD service would not be able to access HBO over the TV Everywhere service offering. Program availability is subject to participation by the programmer that provides the MVPD with the program. Each MVPD offers its own TV Everywhere service (for example, Comcast calls its service Fancast Xfinity). Most of the major MVPDs (cable, satellite, and telephone) have indicated that they plan to participate in TV Everywhere (though to date only Comcast and DISH Network have begun service), as have many of the large programmers. The participants claim that the authentication system works even if a household subscribes to one company for its MVPD service and a different company for its ISP service.

TV Everywhere has been very controversial. On one hand, it expands the availability of programming available to current MVPD subscribers at no additional charge, clearly a benefit to MVPD subscribers, who are thus encouraged to maintain their MVPD subscriptions. It also provides a secure distribution system that provides programmers with some protection against piracy. Currently, the participating programmers have not made their programming available for Internet distribution exclusively through TV Everywhere. But critics of TV Everywhere fear that it creates a mechanism for programmers to agree to exclusive contracts with the MVPDs in the future, potentially denying independent video distributors access to must-have programming, and thus erecting barriers to entry in the video distribution market, to the detriment of consumers. They also are concerned that the participating MVPDs also are ISPs and, absent strong network neutrality rules, could favor their video services at the expense of independent video service providers. These critics claim that, in jointly adopting the TV Everywhere authentication system, a small number of large programmers and MVPDs are illegally acting in concert to harm competition and consumers.[40]

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[39] Kathy Haley, "Sezmi Pilot Attracts 10,000+ Subs in L.A.," *TVNewsChcck*, January 11, 2010, available at http://www.tvnewscheck.com/articles/2010/01/11/daily.11/.

[40] See, for example, Marvin Ammori, *TV Competition Nowhere: How the Cable Industry Is Colluding to Kill Online* (continued...)

In choosing among these distribution options, one of the concerns to programmers has been the inability to accurately measure viewership levels, which is especially important for advertising-supported business models.[41] One observer claims that Nielsen has not been able to devise a method for accurately measuring online viewership except when the online programming includes exactly the same commercials as are run on the cable or broadcast programming, and that Nielsen has not shown an interest in developing a more robust methodology.[42] As a result, critics allege that Nielsen can accurately measure viewers of services like TV Everywhere, but underestimates viewers of services like Hulu, which runs fewer advertisements than the networks. Advertising is more likely to flow to new distribution models whose audiences are measurable by existing ratings services than to distribution models whose audiences are not measured by the ratings services. Whether or not that specific allegation has merit, it highlights the potential impact on the market of an actual or perceived inability to measure the viewership of certain service offerings.

Claims About How the Proposed Comcast-NBCU Combination Would Affect the Video Market

In this uncertain environment, the announced Comcast-NBCU combination has generated a wide range of predictions about market and public policy effects. Some of these claims are specific to Comcast—how it might use its increased negotiating strength to place itself at an advantage or its competitors at a disadvantage, how it might use its vertically integrated structure to pursue innovative business models, or how its vertically integrated structure might stifle its ability to act quickly. Other claims address more broadly industry-wide responses, such as whether the combination will trigger further consolidation.

Claim: Comcast Would Be Able to Use its Vertically Integrated Position to Deny Rival Distributors Access to Programming or to Raise the Cost of That Programming

Comcast faces two sets of rival distributors—(1) the satellite and telephone companies that compete as MVPDs employing largely the same business model as Comcast, and (2) new entrants offering a variety of video streaming services over the Internet and "over the top" services that bring Internet video directly to the television. Both sets of rivals have voiced concern that the Comcast-NBCU combination could restrict their access to programming or raise the cost of that programming.

(...continued)

TV, Free Press, January 2010.

[41] See, for example, Michael Manzo, "Online Content Innovation: Hulu or the Carriers?," *VON e-Newsletter*, November 24, 2009.

[42] Chadwick Matlin, "Nielsen Allies with TV Everywhere. Will it Bring Down Hulu?," published on *The Big Money from Slate*, January 25, 2010, available at http://www.thebigmoney.com/blogs/hulucination.2010/01/25/nielsen-allies-tv-everywhere-will-it-bring-down-hulu.

Comcast vs. Other MVPDs

Perhaps the greatest danger that a vertically integrated company poses to a non-integrated competitor is to deny the competitor access to must-have programming that it owns or controls. Lack of access could even foreclose competitors from the market. Inferior or more expensive access to that programming also could place non-integrated rivals at a competitive disadvantage. The FCC has addressed these issues in past license transfer and rule making proceedings and has concluded that vertically integrated MVPDs might, in certain circumstances, have both the incentive and the ability to deny competitors access to must-have programming or to raise their rivals' costs for the programming. Where it has not had rules in place to address these issues it sometimes has conditioned license transfers on prohibitions against such activities.[43]

Since programming is characterized by very high upfront fixed costs of production and relatively low incremental costs for distribution, it is generally optimal for programmers to attempt to distribute their programming as widely as possible. In some unique circumstances, programmers can generate more profits through an exclusive distribution contract, if the distributor is willing to pay a large premium for the exclusivity that exceeds whatever loss there would be to the programmer from narrower distribution. This strategy may be particularly effective if the exclusive contract has the effect of foreclosing competition to the distributor. Exclusive contracts are more likely to occur when the programmer and distributor are part of a vertically integrated entity; in this situation, it would not be necessary for the programmer and the distributor to negotiate how to share the risks and gains associated with such exclusive distribution. This is less likely to be the case, however, if the programming and distribution functions of the vertically integrated firm are treated as separate profit centers and the programming part of the entity is not comfortable sacrificing profits for the benefit of the distribution part of the entity.

The FCC has identified one situation where a vertically integrated cable company is likely to benefit from exclusivity, to the detriment of competition and consumers.[44] Most cable companies tend to be clustered in small geographic areas where they enjoy fairly high market shares, offering MVPD services in competition with satellite and telephone companies that tend to serve much broader geographic areas. In this situation, if the local cable company owns a regional sports network (RSN) that carries the games of local professional and major college teams, which is must-have programming in that region, it may be able to foreclose entry into its regional market, or limit entrants to niche positions, if it denies competing MVPDs access to the RSN.

The FCC has adopted program access rules[45] that implement the directive in section 628 of the Communications Act[46] that the Commission establish rules to prevent a vertically integrated cable operator from discriminating in the prices, terms, and conditions at which it makes its programming available to non-affiliated MVPDs and to prohibit a vertically integrated cable operator from having exclusive access to the programming in which it has an attributable interest. The plain language of the statute, however, applies only if the vertically integrated company's

[43] See, for example, "Fact Sheet: FCC's Conditioned Approval of NewsCorp-DirecTV Merger," Federal Communications Commission, December 19, 2003, DOC-242402.A1[1].pdf, available at http://www.fcc.gov.

[44] *In the Matter of Applications for Consent to the Assignment and/or Transfer of Control of Licenses: Adelphia Communications Corporation to Time Warner Cable; Adelphia Communications Corporation to Comcast Corporation; Comcast Corporation to Time Warner Inc.; Time Warner Inc. to Comcast Corporation*, MB Docket No. 05-102, Memorandum Opinion and Order, adopted July 15, 2006, released July 21, 2006, at paras. 122-165.

[45] 47 CFR 76.1000-1004.

[46] 47 U.S.C. § 548.

programming is transmitted to distributors via satellite. Some cable-owned programming, in particular the programming of most RSNs, is transmitted to distributors terrestrially (typically over optical fiber or other broadband lines), and thus the existing program access rules have not applied to them. The FCC has investigated cable ownership of RSNs in detail in the context of several license transfers[47] and has found them to be must-have programming. As a result, the Commission has conditioned approval of those license transfers on non-exclusivity and non-discrimination program access requirements that apply to terrestrially delivered as well as satellite-delivered RSNs. In the 2006 order involving the transfer of licenses to Comcast, however, the conditions were imposed only for a six-year period and did not apply to Comcast's terrestrially delivered RSN in Philadelphia. The FCC recently adopted generic program access rules for terrestrially delivered programming, concluding that they did have the authority under section 628 to take such action.[48] The FCC order likely will be challenged in court by one or more cable companies. It is not clear that a combined Comcast-NBCU would affect Comcast's current incentive and ability to retain exclusive distribution of its RSNs. But if the FCC wants to make sure that these new program access rules apply to Comcast's terrestrially delivered RSNs whatever the court ultimately decides, it could include them as conditions for the license transfer. The FCC might be particularly concerned about particular markets where the combined entity would have a major media presence, such as in Philadelphia, where NBC owns a broadcast television station and Comcast owns the cable company and Comcast SportsNet Philadelphia.

Competing MVPDs have expressed concern that, post-combination, NBCU will discriminate against Comcast's competitors by charging them more than they charge Comcast for its broadcast and cable network programming, thereby raising their costs in an anticompetitive fashion. The FCC's program access rules prohibit vertically integrated programmers from discriminating against non-integrated MVPDs in the prices, terms, and conditions of sale or delivery of their programming. In the merger application/public interest statement that Comcast, NBCU, and General Electric jointly filed at the FCC, the companies pledged to obey the program access rules and to extend them to the high-definition feeds of any network whose standard definition feed is subject to the rules and to retransmission consent negotiations for their NBC and Telemundo owned and operated stations.[49] The rules create a formal process for independent MVPDs to bring, and the Commission to adjudicate, a complaint. But some MVPDs have questioned the effectiveness of this process.[50]

The rules allow for the establishment of different prices, terms, and conditions to take into account, among other factors: actual and reasonable differences in the cost of creation, sale, delivery, or transmission of programming; economies of scale, cost savings, or other direct and

[47] See, for example, *In the Matter of Applications for Consent to the Assignment and/or Transfer of Control of Licenses: Adelphia Communications Corporation to Time Warner Cable; Adelphia Communications Corporation to Comcast Corporation; Comcast Corporation to Time Warner Inc.; Time Warner Inc. to Comcast Corporation,* MB Docket No. 05-102, Memorandum Opinion and Order, adopted July 15, 2006, released July 21, 2006, at paras. 122-165. This issue was also addressed by the FCC in the license transfer orders involving Comcast-AT&T and News Corp.-Hughes (DirecTV).

[48] *In the Matter of Review of the Commission's Program Access Rules and Examination of Programming Tying Arrangements,* MB Docket No. 07-198, First Report and Order, adopted and released on January 20, 2010.

[49] *In the Matter of Applications for Consent to the Transfer of Control of Licenses: General Electric Company, Transferor, to Comcast Corporation, Transferee,* Applications and Public Interest Statement, Appendix 8, "Applicants' Voluntary Public Interest Commitments," Commitment # 14 and Commitment # 15, submitted January 28, 2010.

[50] See, for example, "ACA to FCC—Stop the Broadcasters and Media Conglomerates' Abuse of Small Ops," American Cable Association Press Release, September 1, 2009.

legitimate economic benefits reasonably attributable to the number of subscribers served by the distributor; the amount and type of promotional or advertising services provided by a distributor; whether a distributor purchases programming as a package or a la carte; and meeting competition at the distributor level. All these factors make it particularly difficult to parse whether a particular price, term, or condition in a contract is discriminatory.

There are no non-discrimination requirements imposed on non-vertically integrated programmers and distributors; rates, terms, and conditions are based on market negotiations, with some parties in an advantageous position and others not. Although the prices, terms, and conditions of cable network-MVPD contracts and of retransmission consent contracts between broadcasters and MVPDs are kept confidential, it is widely acknowledged in the industry that large MVPDs are able to negotiate better rates and terms than smaller ones.[51] For example, programmers will be loathe to reach an impasse with a large MVPD if that would result in the programmer losing advertising revenues and subscription revenues generated from the millions of households served by that MVPD. Similarly, a broadcaster that controls two broadcast stations in a local market is likely to be able to negotiate higher joint retransmission consent payments for the two broadcast stations than if each station negotiated separately, because an MVPD in the "duopoly" market probably cannot risk losing carriage of the signals of two local stations in the market.[52]

In this market and regulatory environment, it is generally believed that Comcast obtains programming on more favorable terms than most other MVPDs, and presumably this holds for the NBCU broadcast and cable network programming as well as other programming. Reportedly, parties that are in strong negotiating positions have been able to successfully negotiate "most favored nation" (MFN) clauses in their contracts that allow them to modify their contracts to incorporate more favorable terms that have been negotiated by their rivals. In some cases, the party in the stronger position may be the programmer, who can demand an MFN clause.[53] But in some cases the party in the stronger position may be the MVPD, and it is possible that Comcast already has MFN clauses in some of its contracts with programmers. Smaller MVPDs have sought, but have not been able to get programmers to include, such clauses in their contracts.

What would it mean, then, for NBCU, post-merger, to have to provide its programming to all MVPDs on a nondiscriminatory basis when currently the unaffiliated Comcast gets programming on a favorable basis? How would the rules apply? If DOJ and the FCC are concerned about the competitive impact of more favorable contract terms for Comcast than for other MVPDs, it might be more effective to construct specific merger or license conditions than to rely on existing program access rules that may be difficult to apply in this situation.

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[51] For a detailed discussion of the factors affecting retransmission consent (and MVPD-cable network) negotiations, se CRS Report RL34078, *Retransmission Consent and Other Federal Rules Affecting Programmer-Distributor Negotiations: Issues for Congress*, by Charles B. Goldfarb.

[52] See, for example, *Mediacom Communications Corp., Complainant, v. Sinclair Broadcast Group, Inc., Defendant*, CSR No. 8333-C and CSR No. 8234-M, Ex-Parte Comments of Suddenlink Communications in Support of Mediacom Communications Corporation's Retransmission Consent Complaint, submitted December 14, 2009, in which Suddenlink claims that the retransmission consent fees it has negotiated with broadcasters have been higher in those markets where the broadcaster is negotiating on behalf of multiple stations in a market.

[53] For example, in the press coverage of the recent contentious retransmission consent negotiations between News Corp. and Time Warner Cable, it was reported that CBS has a most favored nation clause in its agreement with Time Warner Cable, so that if Time Warner Cable increased its retransmission consent payments to FOX it would automatically trigger an increase in payments to CBS as well. See, for example, Joe Flint, "Deadline looms for Time Warner Cable and News Corp.," *Los Angeles Times*, December 31, 2009.

Competing MVPDs are also concerned about the incentive for a combined Comcast-NBCU to raise prices for programming in a non-discriminatory, which would raise the costs of all distributors. But the combined Comcast-NBCU would benefit since the increase in total NBCU revenues would exceed the increase in Comcast costs.

Comcast and Other MVPDs vs. Independent Internet Video Distributors and Over the Top Service Providers

The challenge for the new video distributors is to convince programmers their business model will benefit the programmers more than the MVPD model because (1) with the new technologies just becoming available now, the real growth in future demand will be for over the top television services that households can access without having to subscribe to an MVPD, and (2) this demand can be monetized to the mutual benefit of the programmers and the new distributors.

A large part of the appeal of the new distributors is lower monthly charges than now prevail for MVPD service. But consumer decisions still are driven significantly by access to must-have programming. Thus, except for those seeking niches in the markets, the new distributors must be able to offer enough must-have programming to attract a threshold level audience.

The new video distributors do not have a single business model. For example, the Sezmi model focuses on demand for the local news and sports programming offered by local broadcast stations plus some popular cable network programs to offer a scaled down version of MVPD service. To accomplish this, Sezmi seems to want to work with local broadcasters to maximize their mutual value. Other new video distribution models focus more on national programming. The key in each case, however, is to make sure that they have continued access to the must-have cable and/or broadcast programming that they plan to feature in their service offerings.

Comcast and the other MVPDs have the incentive to convince the major programmers, who produce most of the must-have programming, that it is in their mutual interest to maintain, and perhaps expand upon, the MVPD business model. Since the primary threat to that model comes from the new video distributors—the Internet video streamers and providers of over the top television service—the MVPDs must convince the programmers that they can meet the new demand for time- and location-shifted programming as well as the new video distributors can, and without the uncertain revenue stream of those new distribution models. As indicated earlier, although the advertising revenue stream generated by the current cable and broadcast business models is slowing down, the revenue stream flowing to both broadcast networks and cable networks from subscriber license fees paid by MVPDs is expected to continue to rise significantly, even as new distribution services enter the market. The introduction of TV Everywhere, supported by most of the large MVPDs and large programmers, suggests that programmers as well as MVPDs see it in their interest to find a business model that will reduce the number of households that disconnect from their MVPD provider, even if it does not monetize Internet video viewing.

Currently, the programmers that have agreed to participate in TV Everywhere have not made their programming available exclusively to the participating MVPDs. Thus must-have programming still is available to the new video distributors. The MVPDs can be expected to push for more exclusive contracts, however. This raises the following questions:

- Is there a tipping point, in terms of the percentage of must-have programming to which a video distributor has access, below which it is not possible for a video distributor to be viable?
- Would the Comcast-NBCU combination increase the likelihood that major programmers will make some or all of their must-have programming available exclusively to TV Everywhere participants?
- Is there a way for new video distributors to participate in TV Everywhere without abandoning their business model?

One can expect that, given Comcast's commitment to TV Everywhere, an affiliated NBCU would also be committed to TV Everywhere. Perhaps more significantly, would the NBCU executives be more likely to support an exclusive relationship with the Internet services of the MVPDs participating in TV Everywhere—at the expense of relationships with independent Internet and over the top video service providers—than if NBCU were unaffiliated? And if so, would a decision by NBCU to only provide programming exclusively to the Internet services of the MVPDs participating in TV Everywhere place pressure on other programmers to follow suit or would one or more major programmers see it as an opportunity to forge favorable distribution relationships with new Internet and over the top video distribution services, thereby reaching the consumers who reject the current MVPD business model?

Claim: Comcast Would Be Able to Use Its Vertically Integrated Position to Favor the Programming of NBCU at the Expense of Independent Programmers

Given the high level of upfront fixed costs associated with program production and with constructing program networks, financial viability and success depends on reaching a threshold level of households. It is widely recognized that independent programmers typically resort to offering an equity position to either a major programmer or to a major MVPD to help gain carriage by enough MVPDs to attain that threshold. Although the level of vertical integration in the video market has declined over time, there continues to be concern that independent programmers may be precluded from the market. In recognition of this concern, Comcast has committed, once it has competed its company-wide migration from analog to digital delivery of programming in 2011, to add two new independently owned and operated channels to its digital line-up each year for three years.[54]

One of the long-standing goals of U.S. media policy is to foster the diversity of voices. One element of that has been to foster a wide diversity of programmers, at both the production and the aggregation levels. The FCC has adopted commercial leased access rules that require cable operators to set aside a certain number of channels for use by unaffiliated commercial programmers; these rules implement section 612 of the Communications Act.[55] Also, to implement section 616 of the Communications Act,[56] the FCC has adopted program carriage

[54] *In the Matter of Applications for Consent to the Transfer of Control of Licenses: General Electric Company, Transferor, to Comcast Corporation, Transferee,* Applications and Public Interest Statement, Appendix 8, "Applicants' Voluntary Public Interest Commitments," Commitment # 13, submitted January 28, 2010.

[55] 47 U.S.C. § 532.

[56] 47 U.S.C. § 536.

regulations prohibiting MVPDs from requiring a financial interest in any program service as a condition for carriage of the service, from coercing a programmer to grant exclusive carriage rights, or from engaging in conduct that unreasonably restrains the ability of the unaffiliated programming vendor to compete fairly by discriminating against the vendor on the basis of affiliation or non-affiliation. Of course, if an independent seeks to offer an equity interest in order to increase its likelihood of gaining carriage, that is not a violation of rules.

The combination of Comcast and NBCU may result in greater carriage by Comcast of NBCU programming, but it is unlikely to be in contravention of any existing rules. As explained earlier, both the major programmers and the major MVPDs appear to have exhausted the strategy of proliferating branded cable networks. But there are two areas of potential expansion—video on demand programming and the secondary streams of multicasting broadcast stations—where Comcast appears to be more likely to carry NBCU programming than independent programming. In its license transfer filing with the FCC, Comcast has attempted to disarm concern about this by tying extensive use of NBCU programming to specific long-standing public interest goals.

Congress has long championed free over-the-air broadcasting as the primary provider of local programming. Some observers have questioned Comcast's commitment to over-the-air broadcasting and questioned whether Comcast would turn NBC into a cable network. As part of its commitment to maintain the NBC broadcast network and owned and operated stations, Comcast has committed to expand the availability of the local news and public interest programming currently offered by those stations on Comcast's On Demand and On Demand Online platforms.[57] Similarly, in support of diversity, Comcast has committed to featuring Telemundo programming, and expand the availability of mun2, on its On Demand and On Demand Online platforms.[58] Comcast also "intends" to expand the availability of over-the-air programming to the Hispanic community by utilizing some of the available digital spectrum for multicasting the programming of the Telemundo network and Telemundo owned and operated stations.[59] Although both local programming and diverse programming for use in VOD services or for multicasting also are available from other, independent sources, it would be hard to question Comcast's use of NBCU programming to further these goals.

Claim: Comcast Will Use the Merger to Change NBC into a Cable Network, at the Expense of Local Programming

Some observers, noting that broadcast networks traditionally have had only a single revenue source—advertising—that currently is facing serious cyclical and structural challenges, have predicted that Comcast might convert NBC to a cable network, abandoning its local affiliated broadcast stations and their local programming.[60] They point to current proposals now being

[57] *In the Matter of Applications for Consent to the Transfer of Control of Licenses: General Electric Company, Transferor, to Comcast Corporation, Transferee,* Applications and Public Interest Statement, Appendix 8, "Applicants' Voluntary Public Interest Commitments," Commitment # 2, submitted January 28, 2010.

[58] *In the Matter of Applications for Consent to the Transfer of Control of Licenses: General Electric Company, Transferor, to Comcast Corporation, Transferee,* Applications and Public Interest Statement, Appendix 8, "Applicants' Voluntary Public Interest Commitments," Commitment # 7 and Commitment # 8, submitted January 28, 2010.

[59] *In the Matter of Applications for Consent to the Transfer of Control of Licenses: General Electric Company, Transferor, to Comcast Corporation, Transferee,* Applications and Public Interest Statement, Appendix 8, "Applicants' Voluntary Public Interest Commitments," Commitment # 6, submitted January 28, 2010

[60] See, for example, Andrew Vanacore, "Broadcasters' woes could spell trouble for free TV," *Yahoo! News,* Dec. 29, (continued...)

analyzed at the FCC to allow broadcasters to sell their unused spectrum to wireless broadband carriers as a possible vehicle for Comcast to make this transition.[61] Comcast has stated it has no intention to do this.[62]

Given the strong trend, discussed earlier, for broadcasters to seek cash payments from MVPDs for retransmission consent, the continued strong demand for local news and sports programming and the strong branding associated with local broadcast stations, as well as the criticism Comcast would face if it abandoned local programming and free, over-the-air programming, it seems unlikely that Comcast would have the incentive to turn NBC into a cable network unless there were a significant change in the market.

But that does not mean that Comcast would not seek to experiment with its acquired national and local broadcast properties in ways that are different from current broadcast models. For example, if Comcast believes that there is little financial benefit to proliferating additional branded program networks, and there are no strong video demands for the extra spectrum made available by the digital transition (despite Commitment #6 in its license transfer application to use such spectrum to expand the availability of over-the-air programming to the Hispanic community), then especially given its ownership of stations in major markets where spectrum is most valuable, it might find its shareholders would benefit most if it sold the unneeded spectrum to wireless broadband carriers. As another example, as Comcast incorporates its cable sports properties and its broadcast sports properties, it might decide to shift some of those from broadcast to cable, especially if it seeks to turn its Versus network into a viable competitor to ESPN.[63]

Comcast's course of action for the NBC network and owned and operated local stations could be affected by a decision that General Electric must make before the combination has been consummated. NBC has long successfully bid for the exclusive television rights to the summer and winter Olympic Games. Given the current economy, it appears that NBC will lose $200 million on the Winter Olympics in Vancouver, Canada, this year.[64] Mindful of the bad economy, the International Olympics Committee has delayed the bidding process for the 2016 Summer Olympics, but the process still is likely to take place while General Electric still owns NBCU. For the first time, golf will be a competitive sport in the 2016 Olympics. Comcast owns the Golf Channel cable programming network. Combined broadcast and cable coverage of the golf competition likely would generate substantial revenues for NBC, boosting how much it could bid for the Games. If GE makes a bid for the Games, it may be at the urging of Comcast.

(...continued)

2009, available at http://www.lubbockonline.com/stories/122909/bus_540670417.shtml.

[61] For a discussion of the FCC activity, see John Eggerton, "FCC's Levin: Broadband Plans Don't Threaten Future of Broadcasting," *Broadcasting & Cable,* December 28, 2009.

[62] *In the Matter of Applications for Consent to the Transfer of Control of Licenses: General Electric Company, Transferor, to Comcast Corporation, Transferee,* Applications and Public Interest Statement, Appendix 8, "Applicants' Voluntary Public Interest Commitments," Commitment # 1, submitted January 28, 2010.

[63] See, for example, Jonathan Storm, "Many possibilities for Comcast and NBC," *philly.com,* posted on December 3, 2009.

[64] Andrew Krukowski, "Ebersol: NBC Will Lose Money on Games," *TVNewsCheck,* January 11, 2010, available at http://www.tvnewscheck.com/articles/2010/01/11/daily.6/.

Claim: A Combined Comcast-NBCU Might Have the Unique Ability to Craft New Business Models That Benefit Consumers

There has been significant concern in both the video industry and the advertising industry that as new digital technologies to distribute video have been developed, the market has not found a way to generate revenues—and, in particular, advertising revenues—to make these new distribution options financially viable.[65] Some observers believe that, as the various industry players try out new business models, there is the need for several things: (1) for the experimenters to understand both the programmer perspective and the distributor perspective; (2) for the experimenters to have sufficient financial staying power to give their new business model some time to incubate; and (3) for the new business model to be employed by an entity that is a sufficiently large presence in the market that others have to follow its lead if it is successful. A combined Comcast-NBCU would meet these three criteria.

In his declaration accompanying the license transfer application,[66] Comcast Senior Vice President for Corporate Development Robert Pick argues that the combination would "ameliorate the negotiations friction that had made it difficult for Comcast, primarily a distribution and communications company, to convince content owners and programmers to work with us to create and deliver more content to consumers in a greater variety of ways." He explains that there are risks associated with attempting to use new business models, and that it has been his experience that both the programmer and the distributor will seek to place the risk on the other party, often resulting in delays that can be overcome if the risk is borne by a single company that performs both functions. He discusses three new business models that Comcast struggled to implement—video on demand, day and date release of new programming, and TV Everywhere—as examples of experiments that were delayed by separate ownership of programming and distribution due to Comcast's need to know upfront "that it will have access to sufficient content to make these businesses successful." Interestingly, all three of these business models to some extent involve "windowing"—timing when particular programming will be made available on the various platforms. It appears that a key element that Comcast seeks is greater control over windowing to maximize the joint return to programmer and distributor. Pick also argues that the combination also provides additional opportunities for cross-marketing programming.

In practice, it is not clear that the merger will create the hoped-for efficiencies and eliminate frictions between the programmers and distributors. Consider, for example, a joint profit maximizing business strategy requiring the programming entity to sacrifice profits so that the distribution entity can gain a greater amount of profits, in the typical environment in which executive salaries are tied to the performance within their particular entity. Frictions may not go away, although it will be easier for senior management to impose decisions that are not seen as beneficial by particular parts of the company. This internal conflict can be substantial if the two entities are of approximately the same size and contribute relatively equally to the company's bottom line or if the company is subject to regulation and therefore is sometimes called on to make public its positions on issues. For example, during the late 1980s, Sprint consisted of a number of local telephone companies that made up about half its business and a long distance

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[65] See, for example, Brian Steinberg, "Comcast Play for NBC Universal Is a Bet on Future of Advertising," *Advertising Age,* November 9, 2009.

[66] *In the Matter of Applications for Consent to the Transfer of Control of Licenses: General Electric Company, Transferor, to Comcast Corporation, Transferee,* Applications and Public Interest Statement, Appendix 7, Declaration of Robert Pick, submitted January 28, 2010.

company that made up half its business. At the time, there were contentious public policy issues at both the state and federal level about the payments that long distance companies should make to local companies for originating and terminating long distance calls. Frequently the two sides of the company prepared testimony outlying their position and then the testimony was withdrawn as the company could not reach internal agreement on a position. Although many aspects of the programmer-distributor relationship are not subject to public review, some issues, such as retransmission consent, are. But even without a public component, the company must be able to achieve internal agreement to move forward.

Some observers have questioned whether the merger will benefit Comcast. Martin Peers of the *Wall Street Journal* states:[67]

> But there is no question the deal will hinder Comcast's ability to respond to the Internet-driven evolution of media. As a cable-systems company, offering both traditional TV and broadband access, Comcast could still make money out of customers if they "cut the cord" by switching off cable-video subscriptions and watching online video instead. As a majority owner of NBC Universal, though, Comcast has to protect the cable-channel business model, which needs people to keep paying subscriptions for TV.

Another significant issue is whether the more efficient business models envisioned for a combined Comcast-NBCU can only be achieved by combining an extremely large MVPD with an extremely large programmer, which could lead to significant consolidation in the industry if small players are forced out of business or to marginal niches and larger players are forced to seek merger partners in order to be able to compete with Comcast-NBCU.

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[67] Martin Peers, "Comcast Risks Double Vision," *Wall Street Journal*, December 4, 2009.