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Position Statement Prepared for
The Federal Communication Commission's Panel on
Challenges Faced by Multichannel Video Programming Distributors

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1. The Federal Communications Commission ("FCC") is interested in understanding the importance of wholesale and retail bundling of non-broadcast programming on competition in the market for subscription video programming services. Here I focus on wholesale bundling, a practice by which multichannel video programming distributors ("MVPDs") could be forced to carry a content owner's less desirable programming in order to obtain carriage rights for the owner's more desirable programming. Specifically, the FCC is interested in the extent to which wholesale bundling affects: (a) bundling and pricing at the retail level; (b) market entry of independent program suppliers; (c) diversity of programming; and (d) whether there is a threshold for determining when program bundling is anticompetitive. This presentation describes some economic principles, relevant trends, and preliminary analyses that may shed light on the potential effects of wholesale bundling.

I. Carriage Negotiations Between MVPDs and Content Owners

2. A handful of large media companies own a substantial amount of programming, as measured in ratings shares. These companies often negotiate terms of carriage for multiple non-broadcast cable networks as part of the same negotiation with individual MVPDs. In these negotiations, MVPDs typically want the right to carry programming on any tier (package), and they want to pay content owners the lowest possible rates per subscriber-month, often referred to as affiliate fees. In contrast, content owners typically want carriage on the most widely penetrated tier, and they want to receive the highest possible affiliate fees. Accordingly, carriage agreements between MVPDs and content owners govern a variety of rights that are heavily negotiated. The terms stipulate affiliate fees and carriage obligations, including a variety of

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packaging requirements. For example, affiliate fees can be tied to the number of subscribers an MVPD can deliver. Packaging requirements may govern one or more related dimensions, including the tier on which the programming might be carried and channel placement, all of which ultimately affect the extent of distribution.

II. Economics of Bundling

3. The practice of selling individual goods as a package is often referred to as "tying" or "bundling."[2] Specifically, tying of two goods occurs when a seller sells one good (the tying good) on the condition that the buyer also buys another good (the tied good) from the seller. Bundling describes the sale of a collection of goods as a single package. Under pure bundling, individual goods are sold only in combination, not separately, making the practice equivalent to tying.

4. There are many reasons why firms may prefer to bundle goods in a single package, particularly in competitive situations. Indeed, a long literature in business and economics highlights a wide variety of circumstances in which competitive firms choose to bundle products that consumers inherently prefer to buy in combination. Examples include the canonical right shoe-left shoe, the auto parts that compose an automobile, a music album, and certain video programming bundles. In such instances, bundling can be both efficient for the firm and more convenient for the consumer. Bundling can also enable a firm to price discriminate and extract more consumer surplus in situations where consumers have heterogeneous preferences across products. In addition, bundling can have anticompetitive uses.[3] It can allow a firm to extend market power from one product to another, more competitive product. In competitive environments, attempts to use (or abuse) bundling in such ways would likely be defeated by the marketplace.

5. As such, an analysis of the competitive effects of bundling (or tying) practices must begin with an assessment of market power. Does the firm engaged in the bundling strategy possess market power over one or more of the bundled goods? If market power exists, one must then assess whether the practice has had any adverse effects on competition. For example, does

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[2] Nicholas Economides, "Tying and Bundling," Palgrave Encyclopedia of Strategic Management, available at: http://www.stern.nyu.edu/networks/Economides_Bundling_and_Tying.pdf.

[3] *The Economist*, "A Bundle of Trouble," July 5, 2001, available at: http://www.economist.com/node/686457.

the bundling practice place upward pressure on MVPDs' costs? Does the practice diminish the diversity of programming that would have existed otherwise? Does the practice diminish competition among content owners? If there is loss of consumer welfare associated with the bundling practice, one must determine whether the procompetitive effects sufficiently offset any anticompetitive concerns. In the remainder of these remarks, I present some initial considerations that would have to be further developed in order to reach conclusions on the net effects of the practice.

III. "Must-Have" Programming Can Confer Market Power

6. There are hundreds of non-broadcast programming networks available today, and some are more popular than others. Marquee programming can take various forms. Some, like the broadcast networks, can have broad-based appeal. Some have a core group of highly dedicated viewers, and some, like Nickelodeon or ESPN, are leaders in certain genres of programming.

7. A network is considered "must-have" for an MVPD if the permanent removal of the network from the distributor's lineup would cause a sufficiently large number of subscribers to switch to another distributor. In the 1990s, the majority of households accessed full-length video programming through their monopoly cable operator, and the risk of losing subscribers to a rival was relatively low.[4] Since then, distribution has become more competitive, first with the emergence of direct broadcast satellite ("DBS") television providers, later with the entry of telephone MVPDs like AT&T and Verizon, and more recently with other facility-based providers like Google Fiber and over-the-top distributors like Netflix and Amazon.[5] Today, 99 percent of television homes can choose among at least three MVPDs and 35 percent can choose among at least four.[6] Most of these homes can also access professional full-length video

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4 Gary Edgerton, *The Columbia History of American Television*, New York: Columbia University Press, 2007, p. 314.

5 FCC's Fifteenth Annual Report, "In the Matter of Annual Assessment of the Status of Competition in the Market for the delivery of Video Programming," July 2013, p.10 and 36. FCC's Sixteenth Annual Report, "In the Matter of Annual Assessment of the Status of Competition in the Market for the delivery of Video Programming," April 2, 2015, ¶ 66 and 85.

6 FCC's Sixteenth Annual Report, "In the Matter of Annual Assessment of the Status of Competition in the Market for the delivery of Video Programming," April 2, 2015, ¶ 31 and Table 2.

programming either online or over-the-air through various antenna technologies.[7] Because of consumer insistence, even program networks with relatively low ratings share can be "must-have" from the perspective of an MVPD. As downstream rivalry among MVPDs has increased, consumer insistence on marquee programming allows content owners to command better terms for carriage.

8. In this environment, market power may not be apparent from an examination of ratings share alone. Television programming is highly fragmented and described as unconcentrated based on traditional HHIs calculated using network and owner rating shares across all broadcast and national basic cable networks. Industry participants have described RSNs and broadcast networks as "must-have." For example, the FCC has described RSN programming as "very likely to be non-replicable and highly valued by customers."[8] I am not aware of any evidence to suggest that other categories or even specific non-broadcast networks are non-replicable or that their permanent removal from a distributor's lineup would cause subscribers to switch to another distributor. One cannot make a determination of whether wholesale bundling is likely to be anticompetitive without a more thorough empirical investigation.

IV. There is Heterogeneity in Popularity of Commonly Owned Networks

9. The concern about the possibility of anticompetitive wholesale bundling is more likely to arise in a circumstance where programmers own a mix of more desirable and less desirable networks. Under the single monopoly profit theory, a programmer that owns a single, highly desirable network can command favorable carriage terms. Similarly, a programmer that owns multiple highly desirable networks can also command favorable terms for each network individually and for a bundle of those networks. Thus, as a predicate matter, it may be useful to look for heterogeneity in the popularity of commonly owned networks.

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7 Meg James and Yvonne Villarreal, "Cord cutters face a sea of streaming options," *LA Times*, January 1, 2016, available at: http://www.latimes.com/entertainment/envelope/cotown/la-et-01013-ct-ott-mania-20151229-story.html.

8 FCC, First Order and Report, "Review of the Commission's Program Access Rules and Examination of Programming Tying Arrangements," January 20, 2010, ¶ 8.

10. A preliminary analysis of the distribution of ratings among commonly owned program networks for each of the top ten owners of broadcast and national basic cable programming shows the following patterns:

- In each instance, the most highly rated network commands primetime ratings that are more than double the ratings of that owner's second highest rated network.
- The second most highly rated network, in turn, commands primetime ratings that are more than double the average ratings commanded by the remaining networks of that owner.

Beyond the top two networks, there is substantially less difference in the popularity of the remaining networks across the different content owners. While this analysis cannot demonstrate any actual impact of wholesale bundling, these patterns suggest that owners of marquee programming may find it profitable to force the sale of their less desirable programming with the sale of their more desirable programming. Whether or not such a strategy is feasible depends on whether the marquee programming is "must-have."

V. Retail Implications of Wholesale Bundling

11. The retail implications of wholesale bundling are ambiguous. Wholesale bundling without any other contractual obligations should have no adverse effects in areas where MVPDs are for all practical purposes not capacity constrained. In this case, an MVPD can place the network they would not have otherwise agreed to carry on any tier of service (even a la carte) and pay the affiliate fee on subscribers who take the service. Wholesale bundling agreements that force the MPVD to carry on the MVPD's most widely penetrated tier a network they would not have otherwise agreed to carry could have one of several effects: (a) they could result in fatter expanded basic packages beyond what may have been optimal for either the MVPD or the consumer; (b) they could squeeze out smaller programmers or push them to higher tiers of service; and/or (c) they would place upward pressure on the quality adjusted retail price for the tier of service on which the MVPD was forced to carry. There is insufficient evidence in the literature to assess the relative importance of these different effects. One should not

automatically attribute the growing size of cable packages or rising cable prices to wholesale bundling, as many other factors could explain these facts.

VI. Networks Launched by Large Content Owners May Be More Likely to Succeed than Those Launched by Small Content Owners

12. To explore the concern that wholesale bundling by large media companies increases barriers to entry for smaller, independent programmers and has adverse effects on innovation incentives, I present a preliminary analysis of survival rates for non-broadcast networks launched between 2005 and 2007.[9] Specifically, I identify and trace the success of these networks by determining whether they are still on-air as of 2016 and whether there is a difference in survival rates across networks launched by large media companies that own marquee programming and those launched by smaller, independent programmers. The following points summarize the main observations:

- There were 68 new non-broadcast networks launched between 2005 and 2007 that were initially on air in 2008.
- Of these, nearly 70 percent were launched by "small" content owners, and about 30 percent by "large" content owners.[10]
- Networks launched by "large" content owners were significantly more likely to survive relative to networks launched by "small" content owners: 86 percent for large owners versus 55 percent for small owners.

13. These results are certainly consistent with the view that small owners are somehow disadvantaged, or at least they were in the late 2000s. However, there are a host of

[9] The analysis uses data from both SNL Kagan 2016 and the FCC's Thirteenth Annual Report on the "Status of Competition in the Market for the Delivery of Video Programming," January 16, 2009. SNL Kagan 2016 provides a list of networks that are currently on-air as of 2016. The FCC's Thirteenth Annual Report provides a list of networks that were on air as of 2008 along with information on when each network was launched. A network that appears on both lists is considered to be still on-air. Supplemental research was conducted for networks missing in SNL Kagan 2016. Some networks simply failed and were off the air by 2016. Some other networks were sold to a different content owner (e.g., Current TV was sold in 2010 to a new owner, Al Jazeera Media Network, who then launched the new network Al Jazeera America) in which case the original network was considered as off the air by 2016. Some networks were renamed or rebranded by the original owner (e.g., Fox Reality, owned by 21 Century Fox, in 2010 was rebranded as Nat Geo Wild, still owned by 21 Century Fox), in which case the original network was considered as "on-air" as of 2016.

[10] For this purpose, a "large" content owner is identified to be one of the top ten media companies, based on total prime time viewership across all broadcast and national basic cable networks: Walt Disney Company, Comcast, 21 Century Fox, CBS Corporation, Time Warner, Viacom, Discovery Communications, Scripps Networks Interactive, Univision Communication, and Crown Media Holdings.

selection issues one should consider in a more fully developed analysis that attempts to control for observable differences in network and owner characteristics. For example, one cannot observe in the data the networks that would have been launched by smaller content owners but were never launched. In addition, one might evaluate whether networks launched by smaller owners had to be "better" than those launched by larger owners, in which case the difference in survival rates would be even bigger after accounting for this bias. One might also evaluate whether bigger owners were better positioned for other reasons to create better programming, with networks that are more likely to survive.

VII. Procompetitive Justifications

14. There exist a variety of procompetitive economic justifications for wholesale bundling, some of which stem from the fact that programmers earn revenues from both advertisers and subscribers. I describe these here:

a. *Risk sharing provides incentives to create new programming.* A substantial barrier to creating new programming is the challenge of obtaining distribution. Wholesale bundling, particularly for content owners that are not vertically integrated, may provide a mechanism to overcome this obstacle and force an MVPD to share some of the risk of launching a new network. For this reason, wholesale bundling may promote investments by content owners that can insist on bundling.

b. *Proliferation of programming by existing content owners tends to create more diversity of programming.* There is a long economics literature studying the effects of competition and ownership concentration on program diversity. Steiner (1952) develops a stylized model of spatial competition that shows that two radio stations owned by different owners would tend to be programmed more similarly than two stations owned by the same owner.[11] Consistent with the theory, some of the empirical literature studying program variety in terrestrial radio tends to find that ownership concentration is at least

[11] Peter Steiner, "Program Patterns and Preferences, and the Workability of Competition in Radio Broadcasting," *The Quarterly Journal of Economics*, May 1952, 194-223.

weakly associated with more formats and increased listening.[12] For this reason, practices that promote investments by existing owners of programming may create incentives for program diversity.

c. *Greater segmentation of target audiences can lead to increased advertising revenue, which in turn would place downward pressure on programming costs.* Wholesale bundling, coupled with channel placement requirements, may enable programmers to more effectively segment and capture potentially valuable target audiences. Given the two-sided nature of the programming revenue model, practices that enable a network to earn higher revenue from advertisers may result in lower affiliate fees charged to MVPDs.

d. *Lower transactions costs, including contracting costs and programming costs.* Lastly, bundling commonly owned networks may allow content owners to lower negotiation and transactions costs compared to contracting on a network-by-network basis.

VIII. Concluding Remarks

15. In theory, wholesale bundling can have both procompetitive and anticompetitive effects. The fact pattern suggests that large media companies may have incentives to use wholesale bundling of their more desirable content with their less desirable or nascent content. It is unclear, however, whether owners of non-broadcast national cable programming have sufficient market power to impose wholesale bundling on MVPDs. The fact pattern also suggests that networks launched by large media companies, with the most desirable programming, are more likely to survive in the marketplace. It is unclear, however, whether this relative success is due to wholesale bundling or other factors. While many questions remain, what is clear is that economic theory by itself yields ambiguous predictions and that evaluation of the issues will require empirical investigation, likely on a case-by-case basis.

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[12] Steven Berry and Joel Waldfogel, "Do Mergers Increase Product Variety? Evidence from Radio Broadcasting," *The Quarterly Journal of Economics*, August 2001, 1009-1025. Robert Rogers and John R. Woodbury, "Market Structure, Program Diversity, and Radio Audience Size," *Contemporary Economic Policy*, Vol. XIV, 1996, pp. 81-91. Tasneem Chipty, "Station Ownership and Programming in Radio," FCC Media Ownership Study, June 2007, available at: https://apps.fcc.gov/edocs_public/attachmatch/DA-07-3470A6.pdf.