

## **APPENDIX 1**

**The Economic Effects of Price Discrimination in Retransmission Consent Agreements, William P. Rogerson, Professor of Economics, Northwestern University**

**Before the  
Federal Communications Commission  
Washington, DC 20554**

In the Matter of )  
 )  
Review of the Commissions' Program ) MB Docket 07-198  
Access Rules and Examination of )  
Program Tying Arrangements )

**THE ECONOMIC EFFECTS OF  
PRICE DISCRIMINATION  
IN  
RETRANSMISSION CONSENT AGREEMENTS**

**by**

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## INTRODUCTION AND SUMMARY

The retransmission consent framework put into place by the 1992 Cable Act<sup>1</sup> allows broadcasters to negotiate compensation from MVPDs in return for providing them with permission to broadcast their signals. Current regulations do not require broadcasters to make their signals available on the same terms to all MVPDs in their broadcast area and there is considerable evidence that broadcasters do, in fact, engage in extensive amounts of price discrimination. In particular, it appears that small and medium-size MVPDs are often required to pay fees that are at least four to five times as high as the fees that large MVPDs pay for permission to retransmit exactly the same broadcast signal. The American Cable Association (ACA) has asked me to provide an analysis of the economic causes and consequences of these discriminatory practices. In particular, they have asked me to consider if the case can be made that allowing such discriminatory practices could potentially result in economic efficiencies of some sort or whether the main effect of these practices is simply that different groups of subscribers are essentially being charged different prices to view the same programming. I have also been asked to consider the feasibility and cost of implementing regulations designed to restrict such discriminatory practices.

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<sup>1</sup>Cable Television Consumer Protection and Competition Act of 1992, Pub. L. No. 102-385, 106 Stat. 1460. *See also* 47 C.F.R. 76.64. This original act applies only to cable system operators. In 1999 Congress enacted the Satellite Home Viewer Improvement Act, Pub. L. NO. 106-113, 114 Stat. 1501, which allows DBS companies to offer local broadcast channels to their subscribers and allows broadcasters to negotiate compensation for providing them with retransmission consent. *See also*, Satellite Home Viewer Extension Reauthorization Act (“SHVERA”), Pub. L. No. 108-447, 118 Stat. 2809 (2004).

My main conclusions are as follows:

1. The main economic cause of price discrimination in retransmission consent agreements is simply that small and medium-size MVPDs are in a considerably worse bargaining position than their larger brethren, because the share of the audience they provide to a typical broadcast station is small enough that the loss of this audience will not generally have any significant impact on the station's advertising revenue.
2. In some markets, price discrimination can have the desirable effect that it provides firms with the incentive and ability to serve more customers by allowing them to simultaneously serve customers with a low ability/willingness to pay for the good at low prices while still serving customers with a higher ability/willingness to pay for the good at higher prices. No such rationale applies in the case of retransmission consent. Obviously, local broadcasters would still provide their signals to the major MVPDs if they were not allowed to charge even higher prices to small and medium-size MVPDs. Therefore the main effect of price discrimination in this case, is simply to allow broadcasters to charge higher prices to MVPDs with less bargaining power.
3. Higher retransmission consent fees are ultimately paid for by the subscribers to MVPDs in the form of higher subscription fees.
4. While there may be a good public policy rationale to require MVPD subscribers to make

modest payments that help support the programming efforts of local broadcasters, the rationale for requiring the customers of small and medium-size MVPDs to make higher payments than the customers of large MVPDs is much less apparent. The government has granted commercial broadcasters with valuable spectrum and provides a range of legal and regulatory protections to help ensure the availability of broadcast television to the public. The use of some of those legal and regulatory protections to extract substantially higher fees from smaller distributors and their customers raises policy questions that the Commission should carefully consider. I think that the Commission should carefully consider whether adjustments to regulations that would spread this burden more equally across all MVPD subscribers would be more consistent with the Commission's public policy objectives.

5. Since retransmission consent fees are projected to continue to rise rapidly, the inequities generated by these discriminatory practices will continue to grow.
6. The current program access regulations provide a model showing how the Commission could implement non-discrimination requirements for retransmission consent fees in a relatively simple and workable fashion

The paper is organized as follows. A brief summary of my qualifications follows this introduction. Then Section 1 describes the factors that affect the bargaining power between MVPDs and broadcasters and explains why smaller MVPDs have considerably less bargaining

power than do larger MVPDs. Section 2 very briefly reviews some of the evidence that small and medium-size MVPDs do, in fact, pay significantly higher retransmission consent fees than larger MVPDs. Section 3 considers the possibility that allowing this price discrimination might somehow enhance economic efficiency and concludes that the normal economic reason why we might expect price discrimination to be efficiency-enhancing in some circumstances does not apply in this case. Section 4 concludes that the main economic effect of allowing price discrimination in this case is simply that different viewers are charged different prices to view the same programming. It also suggests that Commission should carefully consider whether this outcome is consistent with its own policy objectives. Section 5 briefly describes the manner in which current program access regulations prohibit price discrimination by vertically integrated cable programmers and suggests that the same approach could be used to implement nondiscrimination requirements for retransmission consent fees. Finally Section 6 draws a brief conclusion.

## **QUALIFICATIONS**

My name is William P. Rogerson. I am a Professor of Economics at Northwestern University. In 1998-99 I served as Chief Economist at the Federal Communications Commission (“Commission”). I have published numerous academic articles on industrial organization, regulation, the economics of contracts, and telecommunications and I am an elected fellow of the Econometric Society. I have served as Chairman of the Department of Economics at Northwestern University and am currently Co-Director of Center for the Study of Industrial Organization and Director of the Program in Mathematical Methods in the Social Sciences at

Northwestern. I am also a Senior Fellow at the Searle Center on Law, Regulation, and Economic Growth at Northwestern and Director of the Searle Research Program on Regulation and Antitrust. Since my term as Chief Economist at the Commission, I have served as an economic expert to both government agencies and private parties on a number of regulatory issues involving the multi-channel video programming and delivery (MVPD) industry. This includes serving as the economic expert for the Federal Trade Commission in its review of the Time Warner AOL merger and serving as the economic expert for the Association of State Attorney Generals to support their analysis of the DirecTV EchoStar merger. A copy of my curriculum vitae is appended to this paper.

### **1. SMALL AND MEDIUM-SIZE MVPDS HAVE CONSIDERABLY LESS BARGAINING POWER THAN LARGE MVPDS**

The negotiating strength between a local broadcaster and an MVPD is affected by the relative harm that each party would suffer if the MVPD were not to carry the signal of the local broadcaster. The potential harm to the broadcaster is that its viewership would decline and that this would have a negative impact on its ability to earn advertising revenues. The potential harm to the MVPD is that it would have less desirable programming and that it would therefore lose customers to other MVPDs that still carry the signal and/or that it would have to lower its subscription prices to retain customers.

There is widespread agreement among industry participants, policy-makers, and economists and financial analysts that study this industry that the relative balance of negotiating strength between a local broadcaster and MVPD is dramatically different in the case of most

small and medium-size MVPDs than it is in the case of the largest cable system operators or the two large DBS providers. This is primarily because the potential harm that a broadcaster will suffer if the MVPD does not retransmit its signal is dramatically different in each case. In particular, a local broadcaster will typically face the situation where the vast majority of its customer base is located in more urban areas served by one or two very large cable systems and a much smaller fraction of its customer base is located in less developed areas typically served by a much larger number of small cable systems. Of course, the two major DBS providers, DirecTV and Echostar, will also generally make their services available throughout the viewing area. As a result, when a local broadcaster calculates the share of its viewers that subscribe to the various MVPDs that serve its viewing area, it finds that one or two large cable systems typically provide service to the vast majority of its viewers, that the two DBS firms provide service to a smaller but still significant proportion of its viewers and that the share of its viewers that subscribe to any other MVPD is almost too minuscule to calculate. Losing carriage on one of the major cable systems would therefore represent a major loss of viewers for the broadcaster that would likely have immediate and severe repercussions for its advertising revenues. Losing carriage on one of the two DBS providers would create a smaller but still significant revenue loss for the broadcaster. However, losing carriage on a small cable system would not necessarily even be an event that most advertisers would notice.

A recent report by the Congressional Research Service<sup>2</sup> describes the negotiating environment between local broadcasters and MVPDs and its effect on the levels of compensation

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<sup>2</sup>Goldfarb, Charles B. *Retransmission Consent and Other Federal Rules Affecting Programmer-Distributor Negotiations: Issues for Congress*, Congressional Research Services Report for Congress, July 9, 2007 (“CRS Report”).

that broadcasters are able to negotiate with different types of MPVDs in great detail and provides a much more detailed and in-depth picture of the situation than I am able to do in this short paper. I recommend that the interested reader consult this report directly. However I will extract a few particularly relevant quotations from this report. The report contrasts the situation between small and medium-size cable companies versus the major DBS providers as follows.

“Small and mid-size cable companies often face direct competition from the two major satellite companies, DirecTV and DISH Network. These cable companies have fewer subscribers than the major satellite companies and thus when negotiating with programmers typically do not pose a serious risk to the programmers if there is an impasse and the programming is not carried; a programmer’s forgone per subscriber fees from these cable companies and foregone advertising revenues would not be substantial. By contrast, a programmer’s revenues could be significantly reduced if one of the satellite companies discontinued carriage, since each of the satellite carriers have more than 13 million subscribers. [footnote omitted] Moreover, many of the smaller cable companies have limited or no ability to offer bundled video/telephone/broadband services that tend to foster customer retention even when favored programming is no longer carried. Thus, if an impasse were to occur, a smaller cable company would face significant risk of losing subscribers to satellite companies. In fact, where a smaller cable company has had an impasse with a programmer, sometimes the programmer – or a satellite operator that has an agreement with the programmer and is competing with the cable company – has offered a “bounty” of upwards of \$200 to households to switch to the satellite service, with these offers marketed over the programmer’s network while the programmer-cable company negotiations are still on-going. [footnote omitted]”<sup>3</sup>

It also points out that large cable operators are in an even stronger negotiating position than the DBS providers.

“The very large cable companies appear to have been more successful than the two large satellite companies in resisting cash payments, for several reasons. Their strategy to cluster their systems in a limited number of local markets has given them high subscriber penetration in those markets, which helps in negotiations with local broadcast stations. Also, their ability to offer bundles of video, voice, and data services reduces the likelihood that subscribers will change provider based solely on the loss of a particular

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<sup>3</sup>CRS Report at 12.

video program.”<sup>4</sup>

Analysts that follow this industry and industry publications routinely note the same factors. For example the New York Times quotes Sanford Bernstein analyst Craig Moffet as stating:

“it is one thing to wring big fees out of small cable operators, but if CBS goes dark on Comcast, CBS’s distribution would plummet overnight. Comcast may end up paying something , but it is hard to see how it is all that material.”<sup>5</sup>

The industry publication MultiChannel News reports the same analyst as stating that

“two trends are clear from 2007: retrans generates cash and smaller operators, with less leverage than larger cable companies, will bear the brunt of the pain.”<sup>6</sup>

## **2. SMALL AND MEDIUM-SIZE MVPDS PAY SIGNIFICANTLY HIGHER RETRANSMISSION CONSENT FEES THAN LARGE MVPDS**

The almost universal use of non-disclosure clauses in retransmission consent agreements limits the amount of publicly available evidence on the magnitude of retransmission consent fees and how they vary between MVPDs of different sizes. However, the available evidence, which consists largely of media reports and analyst reports, consistently and uniformly suggests that the independently owned affiliates of the four major broadcast networks and the owned and operated affiliates of CBS<sup>7</sup> are now charging fees in the neighborhood of \$.50 per subscriber per month to

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<sup>4</sup>CRS Report at 13

<sup>5</sup>See *Slow and Steady No More*, New York Times, October 19, 2007.

<sup>6</sup>See *Retrans on the Rise*, Multichannel News, January 7, 2008.

<sup>7</sup>The situation is more complicated for the owned and operated(O&O) affiliates of NBC, ABC, and Fox. These networks all produce significant amounts of their own cable network

small and medium-size MVPDs and \$.10 to \$.15 per subscriber per month to the two major DBS providers. Exact figures for the fees that the largest cable operators are paying are more difficult to come by but there is a strong consensus that the fees are certainly no higher than those paid by the DBS providers and may, in fact, be substantially lower.

Some of this evidence has actually been presented in the record of this proceeding in an economic expert report filed by Disney, which is, of course, the owner of one of the four major networks, ABC.<sup>8</sup> Citing a report by Bernstein Research<sup>9</sup> the Disney expert report states that

“Although some of the smaller cable operators may be paying cash for retransmission rights, the major cable operators have resisted such initiatives[ cite to Bernstein Report]. In contrast, satellite operators are already paying cash for retransmission consent, on the order of \$0.10 to \$0.15 per subscriber per month[cite to Berstein Report].”<sup>10</sup>

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programming and the retransmission consent deals they negotiate with MVPDs on behalf of their O&O’s tend to be negotiated as part of larger packages where the MVPDs agree to purchase various cable networks at specified prices. In these cases one would have to calculate the implicit premium that small and medium-size MVPDs are paying for retransmission consent by comparing the prices of the over-all packages of programming that the MVPDs purchase, and I am not aware of any news reports that have attempted to conduct this more involved sort of calculation.

<sup>8</sup>See “Economic Implications of Bundling in the Market for Network Programming,” by Jeffrey Eisenach, January 4, 2008, (“Disney Expert Report”)submitted by The Walt Disney Company as part of “Coments of the Walt Disney Company,” *MB Docket No.07-29, MBDocket No. 01-198*, January 4, 2008.

<sup>9</sup>Berstein Research, *U.S. Media: Cash for Retrans A net Poitive for TV Stations, But Full Financial Benenfit Will Likely Require Large Patience*, Mar. 2006, (“Berstein Report”).

<sup>10</sup>See Disney Expert Report at

Numerous news stories by major national newspapers as well as industry publications report retransmission consent fees paid by smaller cable operators in the range of \$.30 to \$.50.<sup>11</sup> The ACA and other representatives of smaller MVPDs report that many of their members are now charged between \$.50 and \$1.00 per subscriber per month in retransmission consent fees for each of the four major networks. The ACA also reports that one of their members recently received a rate card seeking \$1.65 per subscriber per month as the retransmission consent fee for an affiliate of the one of the major four networks.

As I mentioned above, virtually all retransmission consent agreements contain non-disclosure clauses that prohibit MVPDs from disclosing the terms of these agreements. I think that if the FCC determines that it needs more information about the magnitude and extent of price discrimination before it takes any action on this issue, that it could and should require broadcasters to make systematic information available on the terms of the retransmission agreements that they negotiated with different MVPDs.

It is also worth noting that retransmission consent fees have been rising dramatically over the last few years and that most industry participants and observers are projecting that they will

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<sup>11</sup>*See Channel Change - Television's Power Shift: Cable Pays for Free Shows; Broadcasters Want Cash to Carry Their Signal; Super Bowl is Hostage*, Wall Street Journal, February 5, 2007, page A1 (reporting that Sinclair Broadcasting was asking for retransmission consent fees of \$.50 per subscriber per month from cable operator Suddenlink and that it likely got close to what it was asking for); *Commisso: 'Industry Has Major Issues*, Multichannel News, February 5, 2007 ("Mediacom may have agreed to pay as much as 50 cents per subscriber per month for each of clair's stations according to one party close to the company. The Wall Street Journal Monday put the payments in the range of 30-50 cents."); *CBS Reaches Deals With 9 Cable operators for Compensation to Carry its Programs*, New York Times February 23, 2007 ("[Mr. Moonves] previously predicted at investor conferences that CBS could gain 50 cents a subscriber from these agreements. That amount was widely speculated to be exactly what CBS did secure from at least some of the nine systems involved.")

continue to rise rapidly over the next few years. For example, Kagan research is reported to have projected that retransmission consent revenues will rise from their current level of \$230 million per year to a level of \$1 billion per year in 2010.<sup>12</sup> Thus, the financial significance of retransmission consent fees to both MVPDs and their customers is going to continue to grow in importance over the next few years.

### **3. ALLOWING PRICE DISCRIMINATION IN RETRANSMISSION CONSENT AGREEMENTS DOES NOT EXPAND THE MARKET**

In some markets, price discrimination can have the desirable effect that it provides firms with the incentive and ability to serve more customers by allowing to them to simultaneously serve customers with a low ability/willingness to pay for the good at low prices while still serving customers with a higher ability/willingness to pay for the good at higher prices. No such rationale applies in the case of retransmission consent. Obviously, local broadcasters would still provide their signals to the major MVPDs if they were not allowed to charge even higher prices to small and medium-size MVPDs. Therefore the main effect of price discrimination in this case, is simply to allow broadcasters to charge higher prices to MVPDs with less bargaining power.

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<sup>12</sup>See *Dueling for Dollars*, Multichannel News, March 5, 2007.

#### **4. THE MAIN ECONOMIC EFFECT OF ALLOWING PRICE DISCRIMINATION IN RETRANSMISSION CONSENT AGREEMENTS IS THAT DIFFERENT GROUPS OF VIEWERS ARE BEING CHARGED DIFFERENT PRICES TO VIEW THE SAME PROGRAMMING**

MVPDs pass higher programming costs back to their subscribers in the form of higher subscription fees. Therefore the main effect of price discrimination in retransmission consent agreements is simply that different groups of viewers are being charged different prices to view the same programming.

In a sense, the retransmission consent regime essentially allows local broadcasters to indirectly charge MVPD subscribers a fee for the right to view local broadcasts' signals through their MVPD provider, even though the same signals are provided free over the air. The goal of policy makers when they instituted this policy was to strengthen the financial viability of local broadcasters and to provide them with both the incentive and financial resources to increase the quality of their programming. While there may be a good public policy rationale to require MVPD subscribers to make modest payments that help support the programming efforts of local broadcasters, the rationale for requiring the customers of small and medium-size MVPDs to make higher payments than the customers of large MVPDs is much less apparent. I think that the Commission should carefully consider whether adjustments to regulations that would spread this burden more equally across all MVPD subscribers would be more consistent with the Commission's public policy objectives.

The government has granted commercial broadcasters with valuable spectrum and provides a range of legal and regulatory protections to help ensure the availability of broadcast television to the public. The use of some of those legal and regulatory protections to extract

substantially higher fees from smaller distributors and their customers raises policy questions that the Commission should carefully consider.

#### **5. PROGRAM ACCESS REGULATIONS PROVIDE A WORKABLE MODEL FOR IMPLEMENTING REGULATIONS THAT WOULD RESTRICT PRICE DISCRIMINATION IN RETRANSMISSION CONSENT AGREEMENTS**

A potential difficulty in implementing regulations that would restrict the ability of broadcasters to price discriminate in their retransmission consent agreements is that the agreements in many cases involve more complex terms than a simple cash payment. In particular, as mentioned above, many of the retransmission consent agreements negotiated by the major networks on behalf of their owned and operated affiliates require the MVPDs to carry additional cable network programming produced by the network in return for receiving retransmission consent. If all compensation took the form of stand-alone cash payments, price discrimination could be prevented simply by requiring all broadcasters to publish a rate card which made the same prices available to all MVPDs. Such a requirement would be very simple and easy to enforce. However, because retransmission consent contracts are often more complex, a no-discrimination requirement would have to be implemented by the more general requirement that broadcasters would have to make the same terms available to all MVPDs. This more complex requirement would obviously be somewhat more difficult to verify and enforce.

However, the current program access regulations already provide a model showing that it is possible for the Commission to implement this more complex sort of regulatory requirement in a relatively workable and simple fashion. In particular, the current program access regulations require cable network programmers that are vertically integrated with a cable system to make their

programming available to non-affiliated MVPDS at the same terms and conditions that it is made available to their own affiliated cable systems. The regulation is enforced by allowing aggrieved parties to file complaints with the Commission that are then investigated. The threat that complaints can be filed, and that the subsequent investigation would be costly and time consuming for all involved parties, then provides programmers with some incentive to avoid violations of the rules in the first place. While this system undoubtedly does not work perfectly, I note that the Commission has been satisfied enough with its performance to renew these regulations a number of times.

## **6. CONCLUSION**

There is considerable evidence that small and medium-size MPVDs are charged significantly higher fees for retransmission consent than large MVPDs are charged. The primary explanation for this is simply that small and medium-size MVPDs have considerably less bargaining power in their negotiations with broadcasters. Higher retransmission consent fees are passed through to subscribers in the form of higher subscription fees. The government has granted commercial broadcasters with valuable spectrum and provides a range of legal and regulatory protections to help ensure the availability of broadcast television to the public. The use of some of those legal and regulatory protections to extract substantially higher fees from smaller distributors and their customers raises policy questions that the Commission should carefully consider.

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2000-Present	Director, Program in Mathematical Methods in the Social Sciences (MMSS), Northwestern University
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1998-1999	Chief Economist, Federal Communications Commission (while on leave from Northwestern)
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1984-1990	Associate Professor of Economics, Northwestern University
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Keynote Speaker at European Institute for Advanced Studies in Management (EIASM) Workshop on Accounting and Economics, Bergen, Norway, June 22-23, 2006.

Searle Fund For Policy Research, Research Grant, "Regulation of Interconnection Between Telecommunications Carriers in the Emerging Competitive Environment," June 2002-May 2004.

Elected Fellow of the Econometric Society, 1999.

Smith Richardson Foundation, Inc. Research Grant, "Economic Incentives and the Defense Procurement Process," March 1, 1993 - May 31, 1995.

Olin Fellow at The Center for the Study of the Economy and the State, University of Chicago, October 1, 1989 - June 30, 1990.

NSF Grant SES-8906751, "Profit Regulation of Defense Contractors," August 1, 1989 - July 31, 1991.

Lynde & Harry Bradley Foundation Research Grant, "An Economic Analysis of Defense Procurement Regulations," June 1989 - December 1991.

Named to Household International Professorship in Economics, September 1987 - August 1989

NSF Grant IRI-8705477, "Contracting Under Asymmetric Information," July 1987 - December 1989

NSF Grant SES-8504304, "Moral Hazard, Reputation, and Product Quality," April 1985 - September 1987

NSF Grant SES-8320451, "Moral Hazard, Reputation, and Product Quality," March 1984 - March 1985

Shelby Cullom Davis Fellowship, 1979

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Member of Program Committee, Telecommunications Policy Research Conference (TPRC) September 2001-September 2003.

Member of Editorial Board, *Review of Accounting Studies*, September 1993 to December 2003.

Member of the Illinois Economic Policy Council, September 1999 to September 2000

Member of the Editorial Board, *Journal of Industrial Economics*, October 1995- Sept. 1998.

Editor, *Defense and Peace Economics*, January 1995 - December 1998.

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## **PUBLICATIONS:**

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