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George Mason University

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Representatives Fred Upton and Greg Walden
Energy and Commerce Committee
United States House of Representatives

Dear Chairman Upton and Chairman Walden:

Thank you for the opportunity to respond to the Committee's December 2014 questions on video regulation. The Technology Policy Program of the Mercatus Center at George Mason University is dedicated to advancing knowledge about the effects of regulation on society. As part of its mission, the program conducts careful and independent analyses that employ economic and legal scholarship to assess legislation and regulation from the perspective of the public interest. Therefore, this response does not represent the views of any particular affected party but is designed to assist Congress as it explores these issues.

Please find attached a research paper by technology scholar Adam Thierer and me about the history of television regulation. This is an age of content abundance and competitive distribution, and we recommend paring down existing video regulations. While the paper was published a few months before the committee's request for comment, it is responsive to the questions posed about industry developments and possible reforms. We show that the labyrinthine communications and copyright laws governing video distribution are now distorting the market and therefore should be made rational. Congress should avoid favoring some distributors at the expense of free competition. Instead, policy should encourage new entrants and consumer choice.

The focus of the committee's white paper on how to "foster" various television distributors, while understandable, was nonetheless misguided. Such an inquiry will likely lead to harmful rules that favor some companies and programmers over others, based on political whims. Congress and the FCC should get out of "fostering" the video distribution markets completely. A light-touch regulatory approach will prevent the damaging effects of lobbying for privilege and will ensure the primacy of consumer choice.

Some of the white paper's questions may actually lead policy astray. Question 4, for instance, asks how we should "balance consumer welfare and the rights of content creators" in video markets. Congress should not pursue this line of inquiry too far. Just consider an analogous question: how do we balance consumer welfare and the interests of content creators in literature and written content? The answer is plain: we don't. It's bizarre to even contemplate.

Congress does not currently regulate the distribution markets of literature and written news and entertainment. Congress simply gives content producers copyright protection, which is generally applicable. The content gets aggregated and distributed on various platforms through private ordering via contract. Congress does not, as in video, attempt to keep competitive parity between competing distributors of written material: the Internet, paperback publishers, magazine publishers, books on tape, newsstands, and the like. Likewise, Congress should forego any attempt at "balancing" in video content markets. Instead, eliminate top-down communications laws in favor of generally applicable copyright laws, antitrust laws, and consumer protection laws.

As our paper shows, the video distribution marketplace has changed drastically. From the 1950s to the 1990s, cable was essentially consumers' only option for pay TV. Those days are long gone, and consumers now have several television distributors and substitutes to choose from. From close to 100 percent market share of the pay TV market in the early 1990s, cable now has about 50 percent of the market. Consumers can choose popular alternatives like satellite- and telco-provided television as well as smaller players like wireless carriers, online video distributors (such as Netflix and Sling), wireless Internet service providers (WISPs), and multichannel video and data distribution service (MVDDS or "wireless cable"). As many consumers find Internet over-the-top television adequate, and pay TV an unnecessary expense, "free" broadcast television is also finding new life as a distributor.

The *New York Times* reported this month that "[t]elevision executives said they could not remember a time when the competition for breakthrough concepts and creative talent was fiercer" ("Aiming to Break Out in a Crowded TV Landscape," January 11, 2015). As media critics will attest, we are living in the golden age of television. Content is abundant and Congress should quietly exit the "fostering competition" game. Whether this competition in television markets came about because of FCC policy or in spite of it (likely both), the future of television looks bright, and the old classifications no longer apply. In fact, the old "silo" classifications stand in the way of new business models and consumer choice.

Therefore, Congress should (1) merge the FCC's responsibilities with the Federal Trade Commission or (2) abolish the FCC's authority over video markets entirely and rely on antitrust agencies and consumer protection laws in television markets. New Zealand, the Netherlands, Denmark, and other countries have merged competition and telecommunications regulators. Agency merger streamlines competition analyses and prevents duplicative oversight.

Finally, instead of fostering favored distribution channels, Congress' efforts are better spent on reforms that make it easier for new entrants to build distribution infrastructure. Such reforms increase jobs, increase competition, expand consumer choice, and lower consumer prices.

Thank you for initiating the discussion about updating the Communications Act. Reform can give America's innovative telecommunications and mass-media sectors a predictable and technology-neutral legal framework. When Congress replaces industrial planning in video with market forces, consumers will be the primary beneficiaries.

Sincerely,

Brent Skorup
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RESEARCH

VIDEO MARKETPLACE REGULATION
A Primer on the History of Television Regulation and Current Legislative Proposals

Adam Thierer and Brent Skorup

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Brent Skorup is a research fellow in the Technology Policy Program at the Mercatus Center. His research topics include radio spectrum rights, antitrust policy, new media regulation, and telecommunications. He has provided expert commentary for outlets like C-SPAN and the *Washington Post*. His work has appeared in several law reviews, *Wired*, *RealClearMarkets*, *The Hill*, and elsewhere. He also contributes to the *Technology Liberation Front*, a leading technology policy blog. Skorup has a BA in economics from Wheaton College and a JD from the George Mason University School of Law. He was formerly the director of operations and research at George Mason University School of Law's Information Economy Project, a research center in Arlington, Virginia, that applies law and economics to telecommunications policy.

ABSTRACT

The television distribution marketplace has been substantially regulated since the advent of broadcast television in the 1940s and 1950s. The Federal Communications Commission and Congress have relied on several justifications for the regulatory protection of the system of local broadcasters envisioned post–World War II, namely, (1) universal service, (2) localism, (3) free television, and (4) competition. These policy goals are at odds with one another and can only be supported simultaneously through far-reaching regulations like compulsory copyright licenses, network nonduplication rules, retransmission consent regulations, and industry concentration prohibitions. We describe the history of these and other regulations. We argue that regulatory repeal would improve distorted television markets and improve consumer welfare. Finally, we describe pending video legislation and explain how various pending bills would affect the current regulatory system.

JEL codes: L510, L520

Keywords: television, FCC, policy, telecommunications, retransmission consent, cable, broadcast, satellite, compulsory license, copyright

> What distinguishes TV programs from other mass media content . . . is the extreme eagerness of Washington to engage in efforts to prevent markets from working freely, often in response to interest group pressures and opportunities for political advantage and with almost complete indifference to the welfare of consumers.[1]
>
> —Bruce Owen

In a free market in video services, television distributors and creators would be able to contract freely and sell any variety of bundles of content to subscribers on any distribution platform they prefer.[2] Competition and consumer protection law, not *ex ante* distribution mandates, would guide business decisions.

Alas, that is not possible today. Indeed, the United States never had anything resembling a truly free market in the provision of television content and services. The video marketplace has been substantially regulated since the advent of broadcast television in the 1940s and 1950s.[3] These regulations have been enforced by the Federal Communications Commission (FCC), an agency regularly captured by the interests it regulates.[4] Because broadcasters used free government-provided

1. Bruce M. Owen, "Consumer Welfare and TV Program Regulation" (working paper, Mercatus Center at George Mason University, Arlington, VA, 2012), 5, http://mercatus.org/publication/consumer-welfare-and-tv-program-regulation.
2. "One major difference between markets for telecommunications goods and markets for other goods is that governmental regulation plays a very large role in determining what kinds and quality of telecommunications services may be offered at what costs. The central issue in telecommunications law is why telecommunications goods and markets are not treated like most other goods and markets." Thomas G. Krattenmaker and Lucas A. Powe Jr., *Regulating Broadcast Programming* (Washington, DC: AEI Press, 1994), 49.
3. See, e.g., Thomas W. Hazlett, "If a TV Station Broadcasts in the Forest . . . : An Essay on 21st Century Video Distribution" (paper commissioned by the American Television Alliance, 2011), http://www.americantelevisionalliance.org/wp-content/uploads/2011/05/TV-Future-TWH-5-19-111.pdf.
4. Adam Thierer and Brent Skorup, "A History of Cronyism and Capture in the Information Technology Sector," *Journal of Technology Law & Policy* 18, no. 2 (forthcoming 2014).

airwaves,[5] the government withheld full First Amendment protections and imposed a variety of obligations on broadcasters, ostensibly in the public interest.[6]

When competing television technologies like cable and satellite arrived and threatened the government-created broadcast markets, the FCC and Congress imposed obligations in an ill-conceived attempt to maintain government-managed competition.[7] "There are few alleyways of the administrative state more obscure or more littered with obstacles to efficient markets and improvements in consumer welfare than the interventions regulating ownership and licensing of TV stations and programs," summarizes media economist Bruce Owen.[8]

Despite this regulatory morass, the video marketplace has undergone a remarkable metamorphosis over the past two decades. This development is not due to the evolution of policy but rather to the rapid evolution of technology.[9] New video technologies and business models have, in essence, evolved around regulatory encumbrances. Cable and satellite companies have invested in their networks and vastly expanded their channel capacity and, therefore, consumer choice. Further, the rise of Netflix, Amazon, YouTube, Apple iTunes, video game platforms, and countless other online video sites and services have made it easier than ever for consumers to find the content they demand. In other cases, companies like Aereo have relied on regulatory arbitrage to create new businesses. Aereo captures free over-the-air broadcasts on small antennas in one location and then leases the antennas to customers in the local area. Customers can watch these broadcasts via a broadband connection.

These technological developments have severely strained the adequacy of existing video laws, which had their last major updates in the 1992 Cable Act[10] and the 1996 Telecommunications Act.[11] Since that time, Congress has only tinkered around

5. Most current broadcast station owners have paid substantial sums for their broadcast networks and spectrum, but the original grants were assigned to broadcasters for free. See Jeffrey A. Eisenach, "The Equities and Economics of Property Interests in TV Spectrum Licenses" (working paper, 2014), http://www.nab.org/documents/newsRoom/pdfs/011614_Navigant_spectrum_study.pdf.
6. "In view of the scarcity of broadcast frequencies, the Government's role in allocating those frequencies, and the legitimate claims of those unable without governmental assistance to gain access to those frequencies for expressions of their views, we hold the regulations and ruling at issue here both authorized by statute and constitutional." Red Lion Broadcasting Co. v. FCC, 395 U.S. 367, 400–1 (1969); see also Krattenmaker and Powe, *Regulating Broadcast Programming*, 229–36, 297–331.
7. See discussion above regarding must-carry, retransmission consent, nonduplication, and other regulatory obligations.
8. Owen, "Consumer Welfare and TV Program Regulation."
9. See Adam Thierer and Grant Eskelsen, *Media Metrics: The True State of the Modern Media Marketplace* (PFF Special Report, Summer 2008), Progress & Freedom Foundation website, www.pff.org/mediametrics; Adam Thierer, president, Progress & Freedom Foundation, Video Competition in a Digital Age, Testimony before the House Subcommittee on Communications, Technology and the Internet (October 22, 2009), www.pff.org/issues-pubs/testimony/2009/10-22-09-thierer-testimony-video-competition-digital-age.pdf.
10. Pub. L. No. 102-385.
11. Pub. L. No. 104-104.

the margins of this complex regulatory regime. Most notably, satellite legislation, which was most recently authorized via the Satellite Television Extension and Localism Act of 2010 (STELA),[12] extended many cable regulations to include satellite video. And, as noted below, recent efforts to reform media ownership rules resulted in few changes.

With the likely congressional reauthorization of STELA in 2014, Congress, the FCC, and industry players have turned their attention to arcane video laws. This paper, beyond simply describing what terms like "retransmission consent" and "network nonduplication" mean,[13] also analyzes video reform proposals and makes the case for comprehensive deregulation.

Americans currently enjoy what media critics call the Golden Age of Television; programming quality is arguably the best it has ever been.[14] However, consumers also see high cable and satellite bills, in part because of the regulatory mandates that distort market negotiations and limit competition. With the required reauthorization of STELA in 2014, public fights over rising retransmission consent fees, and the possible disruption to existing broadcast markets posed by Aereo, there is a sense that the industry and members of Congress have an appetite for video reform. Several bills pending in the second session of the 113th Congress are summarized below. Portions of those bills may be attached to the STELA reauthorization or considered in future video law reforms. Most of these bills increase video regulation. Only one bill subject to our analysis moves television law in a significantly free-market direction. To provide context for these bills, we first discuss some of the history that led to the current calls for reform of video regulations.

HOW THE LEGAL THICKET GREW

It is impossible to make sense of the pending video bills without understanding the history of existing communications laws. The history of television, therefore, will be briefly explored here.

Broadcasters, beginning in the 1940s and 1950s with their original grant of free spectrum, have long enjoyed favoritism from the FCC and Congress. Cable was

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12. Pub. L. No. 111-175.

13. Researchers at the Congressional Research Service and Government Accountability Office provide excellent background for policymakers. See, e.g., Charles B. Goldfarb, *A Condensed Review of Retransmission Consent and Other Federal Rules Affecting Programmer-Distributor Negotiations* (CRS Report for Congress, July 9, 2007).

14. "The vast wasteland of television has been replaced by an excess of excellence." David Carr, "Barely Keeping Up in TV's New Golden Age," *New York Times*, March 9, 2014, http://www.nytimes.com/2014/03/10/business/media/fenced-in-by-televisions-excess-of-excellence.html?_r=0; see also Lee Cowan, "Welcome to TV's second 'Golden Age'" (October 1, 2013), CBS News website, http://www.cbsnews.com/news/welcome-to-tvs-second-golden-age/; Adam Thierer, "We Are Living in the Golden Age of Children's Programming" (Progress Snapshot, July 2009), Progress & Freedom Foundation website, http://www.pff.org/issues-pubs/ps/2009/ps5.6-childrens-television-golden-age.html.

regulated in the 1960s "because, in the FCC's judgment, it posed a threat—if unregulated—to 'free television.'"[15] As the Copyright Office said in a 2008 report, today there is a "thicket of communications law requirements aimed at protecting and supporting the broadcast industry."[16] Television regulations attempt to further several public policy goals and, as the Congressional Research Service has said, the furtherance of some objectives impedes other objectives.[17] Those FCC and congressional objectives include the following:

1. *Localism*. Broadcasts should emphasize diverse content of local interest and importance.
2. *Universal service*. Every media market, no matter the size or population density, should be served by several broadcasters.
3. *Free television*. Broadcasts should be free to any person with a broadcast antenna. Subscription service is essentially prohibited.
4. *Competition*. Broadcast as a distribution method should remain viable to compete with pay-television (cable, satellite, and IPTV) distributors.

These objectives cannot be accomplished simultaneously without substantial ongoing regulatory interventions. At times, these goals may even contradict each other. For example, the push by policymakers to ensure "localism" in broadcasting has, at times, undermined the development of greater national competition.[18] Further, "free"—that is, advertiser-supported—television contradicts universal service because remote parts of the country cannot command the advertising dollars needed.[19]

Many related federal rules therefore continue to tip the regulatory scales toward local broadcasters and content creators. Examples include the requirement that video distributors carry broadcast signals even if customers don't demand the channels (must-carry); rules that prohibit distributors from striking deals with broadcasters outside their local communities (network nonduplication and syndicated

15. Charles O. Verrill Jr., "CATV's Emerging Role: Cablecaster or Common Carrier?," *Law and Contemporary Problems* 34 (1969): 593. See also Glen O. Robinson, "Regulating Communications: Stories from the First Hundred Years," *Green Bag Journal* 13 (2010): 309; Krattenmaker and Powe, "Regulating Broadcast Programming," 225.
16. US Copyright Office, Satellite Home Viewer Extension and Reauthorization (SHVERA) Report § 109 (2008), 65, http://www.copyright.gov/reports/section109-final-report.pdf (hereafter cited as SHVERA Report).
17. Goldfarb, *Condensed Review of Retransmission Consent*.
18. David Weinstein, *The Forgotten Network: Dumont on the Birth of American Television* (Philadelphia: Temple University Press, 2004). Further, as an early television scholar said, "If local programming and control are to be encouraged, it might be more efficient to subsidize local stations directly than to restrict their competitors." Franklin M. Fisher, "Community Antenna Television Systems and the Regulation of Television Broadcasting," *American Economic Review* 56 (1966): 329.
19. Megan Mullen, *Television in the Multichannel Age: A Brief History of Cable Television* (Malden, MA: Blackwell Publishing, 2008), 85.

exclusivity); regulations specifying where broadcast channels appear on the cable channel lineup; rules covering how video distributors carry signals from local TV broadcasters (retransmission consent); and prohibitions against carrying some sporting events (sports blackout).

It's tempting to try to fix just one part of video laws—like retransmission consent, which is the subject of the most intense debates today—but that may only result in more market distortions.[20] Comprehensive video reform requires that *all* of the following regulatory obligations be addressed.[21]

Network Nonduplication and Syndicated Exclusivity

Broadcasters had a relatively stable, competitive environment in the 1950s, with the same three national networks—NBC, ABC, and CBS—and a few local independents broadcasting mostly via local affiliates in FCC-created local geographic zones.[22] In these early years of broadcast television, the FCC made a conscious choice to pursue localism; rather than permit many broadcasters to compete regionally or nationally, the FCC opted to have a few broadcasters in each small market.[23] But in the mid-1950s, "cable" companies began setting up broadcast receivers and connecting receivers to households that could not receive adequate broadcast signals because buildings or geography interfered with their broadcast signal reception.

At first, broadcasters tolerated or welcomed these cable upstarts—more households receiving broadcast signals meant more advertising revenue.[24] However, within a few years, cable companies were capturing broadcast signals from faraway transmitters and importing those signals via microwave and wire into their local city.[25] A rural California cable company, for instance, might capture and transmit popular Los Angeles stations, which had previously been inaccessible to rural households.[26] Producers of local broadcast content, particularly independents not affiliated with the major networks, couldn't compete with the imported signals

20. Adam Thierer, "Video Marketplace Deregulation: The Battle over Spectrum Policy and Retransmission Consent Reform" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, June 19, 2012), http://mercatus.org/publication/video-marketplace-deregulation-battle-over-spectrum-policy-and-retransmission-consent.
21. Adam Thierer, "Toward a True Free Market in Television Programming," *Forbes*, February 19, 2012, http://www.forbes.com/sites/adamthierer/2012/02/19/toward-a-true-free-market-in-television-programming.
22. Hazlett, "If a TV Station Broadcasts in the Forest," 6. DuMont was a fourth national network, but it folded in 1955.
23. Ibid.
24. "In its early form CATV was not viewed as competitive with 'local' and 'free' television broadcasting; in fact, it was arguably a positive factor to those stations whose signal was made available in theretofore unserved areas." Verrill, "CATV's Emerging Role."
25. Fisher, "Community Antenna Television Systems."
26. Hazlett, "If a TV Station Broadcasts in the Forest," 33.

from cities.[27] The FCC soon realized that "distant signal importation" threatened the viability of many small-market broadcasters and the FCC's localism vision.[28]

To protect local broadcasters from competition, the FCC crafted rules in 1966—like network nonduplication and syndicated exclusivity—that kept localism intact.[29] Network nonduplication and syndicated exclusivity require a cable operator to black out certain programs from nonlocal broadcast stations if the local broadcaster has an exclusive arrangement with a network to carry that programming.[30] Today, when broadcasters and multichannel video program distributors (MVPDs)—the largest of which are cable and satellite operators—are at an impasse over carriage payment, the MVPD cannot negotiate with other broadcasters to provide customers content in the interim.[31] If a Washington, DC, cable company, for instance, cannot reach a deal with the DC NBC affiliate over retransmission consent (explained below), the cable company cannot negotiate with Baltimore's NBC affiliate to provide NBC content to DC customers in the interim because of network nonduplication rules. Until the impasse is resolved, customers generally lose the ability to watch certain channels.

Must-Carry

Must-carry is a requirement from a 1966 FCC proceeding,[32] codified in the 1992 Cable Act, that a local cable distributor carry every local broadcast station that requests carriage.[33] As a mandated part of cable's bundle of channels, it is a policy clearly at odds with a free market. Must-carry ensures that local broadcasters are not dropped by distributors, which would result in the loss of needed advertising dollars. Today, must-carry is mostly utilized by low-value or niche broadcast channels, like home shopping programming, since there is not sufficient consumer demand for carriage of those channels on MVPDs. For non-broadcast networks that

27. Mullen, *Television in the Multichannel Age*, 65–66.
28. Ibid., 65.
29. Federal Communications Commission, In the Matter of Amendment of Subpart L, Part 91, to Adopt Rules and Regulations to Govern the Grant of Authorizations in the Business Radio Service for Microwave Stations to Relay Television Signals to Community Antenna Systems, 2 FCC 2d 725, 746 (1966).
30. Mullen, *Television in the Multichannel Age*, 66–67.
31. "FCC rules that limit 'distant signals' resemble cartel enforcement devices, limiting cross-market competition among stations for viewers. While premised on the idea of copyright protection, they actually achieved something quite distinct: protection of local broadcast stations." Hazlett, "If a TV Station Broadcasts in the Forest," 34.
32. The FCC's must-carry rules were overturned in 1985. See Quincy Cable TV, Inc. v. FCC, 768 F.2d 1434 (DC Cir. 1985).
33. Federal Communications Commission, In the Matter of Amendment of Subpart L, Part 91, to Adopt Rules and Regulations to Govern the Grant of Authorizations in the Business Radio Service for Microwave Stations to Relay Television Signals to Community Antenna Systems, 2 FCC 2d 725, 746 (1966); 47 U.S.C. § 534.

cannot take advantage of must-carry, programmers pair unprofitable niche channels—like VH1 Classic—with popular ones—like MTV—to gain cable carriage. As stand-alone broadcast channels, however, there is generally not enough customer demand to include certain channels. In contrast, popular broadcast networks—like NBC, ABC, Fox, and CBS—and their affiliate broadcasters do not elect must-carry. Instead, they have leverage to withhold their signals from cable and satellite companies and request payment via retransmission consent agreements (discussed below).

Compulsory Licenses

Gaining copyright permissions was difficult in the early years of cable because of the numerous parties involved in the production of programming. Television programmers had license agreements with local broadcasters but not with cable companies, which were small and geographically disbursed. Therefore, programmers in the 1960s complained to courts that cable companies were violating their copyright protections, since cable companies were not paying to transmit the programs. In 1968, the Supreme Court resolved the dispute by declaring cable systems mere "extended antennas" for broadcast signals, thus not engaging in public performances of copyrighted material.[34] Congress responded a few years later with the 1976 Copyright Act that granted cable operators a compulsory license to transmit programs airing in distant (nonlocal) TV markets in return for a fee established by the Library of Congress.[35]

Compulsory licenses essentially place a "duty to deal" upon content owners. Compulsory licensing is an attempt to lower the transaction costs to cable companies and programmers. Rather than conducting cumbersome negotiations with all nonlocal broadcasters and networks, cable operators can receive the copyright licenses simply by paying royalties into a government-administered fund that pays out to the programmers. Section 111 of the Copyright Act provides for the compulsory licensing of nonlocal content to cable companies; section 119, added in 1988, extends the royalty-and-licensing scheme to satellite television providers.

Retransmission Consent

Retransmission fees—which MVPDs pay to local broadcasters—might be the most controversial part of today's video marketplace because they have increased in the past few years beyond most expectations. The contractual disputes over the price of broadcast signals are disruptive to consumers, since television viewers lose popular channels while negotiations drag on.

34. Fortnightly Corp. v. United Artists, 392 U.S. 390 (1968); United States v. Southwestern Cable Co., 392 U.S. 157 (1968).
35. 17 U.S.C. § 111(c).

The retransmission consent regulatory regime was created in the 1992 Cable Act at the behest of the broadcasters, who had unsuccessfully sought the rule since the late 1950s.[36] Cable companies, in the 1970s and 1980s, ate into broadcast television's market share as consumers mothballed their rabbit-ear antennas in favor of cable subscriptions. Cable gained its competitive advantage because operators had begun offering cable channels like HBO and ESPN in addition to broadcast channels. In the 1980s, broadcasters anxiously noted that cable companies had two sources of income: from advertisers on new cable programs and from cable subscribers. Local broadcasters, however, had only one source of income—advertising support—because broadcast licensees were essentially prohibited from offering subscription services since their inception.

To gain a second stream of income, broadcasters lobbied Congress for the creation of a brand-new property right, known as the retransmission right. In the 1992 Cable Act, Congress created retransmission rights for broadcasters. While cable carriage of nonlocal signals is covered by the compulsory license, broadcasters of local signals elect either must-carry or retransmission consent every three years.[37] MVPDs today must pay broadcasters who elect retransmission consent for the right to retransmit local broadcast signals, the most valuable of which is programming from the broadcast networks ABC, NBC, Fox, and CBS.

Market dynamics have changed substantially since 1992. The 1980s and early 1990s were a relatively stable negotiation environment because cable providers had a local franchise or de facto monopoly for pay television and broadcasters had exclusive rights to network programming. Broadcasters and cable had near parity in bargaining power since each needed the other. Therefore, money rarely changed hands. Cable systems lost bargaining power in the late 1990s, however, as cable was deregulated and satellite companies began competing away cable customers.[38] If a cable company didn't pay adequate retransmission fees for a broadcast channel, it risked losing customers to satellite companies, which had the same channels and nationwide coverage. With competition among MVPDs intensifying, broadcasters gained the upper hand and could extract retransmission payment as the only sellers of network shows and sporting events.

Further weakening MVPDs' position was network nonduplication and syndicated exclusivity regulations (described previously). The weakened position of pay-TV distributors meant payments to broadcasters rose quickly. Total retransmission

36. Patrick R. Parsons, *Blue Skies: A History of Cable Television* (Philadelphia: Temple University Press, 2008), 157.
37. 47 U.S.C. § 325(b)(3).
38. "As a result [of MVPD competition], programmers have more options available to them to reach audiences and are able to negotiate with distributors from a position of strength." Goldfarb, "A Condensed Review of Retransmission Consent."

fees were negligible in the 1990s, but they rose to $11 million in 2001[39] and then ballooned to around $3.3 billion in 2013.[40]

It is important to note that most television programming deals today operate outside the retransmission system since retransmission does not cover nonbroadcast programming like MTV, ESPN, Bravo, and hundreds of other channels. "Today, more than 500 non-broadcast television channels are distributed by MVPDs nationwide without any need for government compulsory licensing," observes Preston Padden, a former Disney and News Corp. executive.[41] As Padden noted in congressional testimony,

> The success of the marketplace "rights aggregator" model in facilitating the distribution of the programs on non-broadcast channels demonstrates that there is no longer any need for government Compulsory Licensing of broadcast programming. Just like the non-broadcast channels, broadcast stations easily could aggregate the rights in the programs on their schedule and then negotiate with MVPDs.[42]

There are occasional disputes and blackouts that occur when a content company cannot strike a deal with a cable or satellite operator. This is what occurred in 2012 in carriage spats between AMC and Dish[43] as well as Viacom and DirecTV.[44] There are no special rules that either side could rely on in those instances. But in both cases, these contractual disputes were resolved in fairly short order and programming continued. This is what would occur for broadcast programming in a free marketplace. Contractual carriage disputes and even occasional blackouts

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39. Katerina Eva Matsa, "Time Warner vs. CBS: The High Stakes of Their Fight over Fees" (August 21, 2013), Pew Research Center website, http://www.pewresearch.org/fact-tank/2013/08/21/time-warner-vs-cbs-the-high-stakes-of-their-fight-over-fees/.
40. SNL Kagan, "SNL Kagan Releases Updated Industry Retransmission Fee Projections," press release, November 22, 2013, http://www.snl.com/InTheMedia.aspx. Further, retransmission's ostensible purpose—to provide revenue to local broadcasters—largely isn't even accomplished today, since the national broadcast networks require "reverse retransmission," where local broadcasters remit a portion of their retransmission payments to the network. Richard Greenfield, "The Disequilibrium of Power: How Retransmission Consent Went So Wrong and How to Fix It" (August 27, 3013), AllThingsD website, http://allthingsd.com/20130827/the-disequilibrium-of-power-how-retransmission-consent-went-so-wrong-and-how-to-fix-it.
41. *Testimony of Preston Padden, Senior Fellow, Silicon Flatirons Center, Colorado Law, University of Colorado, Before the Committee on Commerce, Science and Transportation, United States Senate*, 112th Cong. 4 (July 24, 2012), http://siliconflatirons.com/documents/publications/policy/PaddenTestimony.pdf.
42. Ibid.
43. William Launder and Suzanne Vranica, "The Plot Thickens for AMC as Blackout Crimps Growth," *Wall Street Journal*, Aug. 20, 2012, http://online.wsj.com/news/articles/SB10000872396390444233104577595771359471812.
44. Brian Stelter, "DirecTV and Viacom Settle Dispute over Fees, Restoring Service," *New York Times,* July 20, 2012, http://mediadecoder.blogs.nytimes.com/2012/07/20/directv-and-viacom-settle-dispute-over-fees-restoring-service/?_php=true&_type=blogs&_r=0.

will continue but will be resolved.[45] There is no reason to apply special carriage rules to some content companies simply because some of their properties are broadcast stations.

Media Ownership

The regulatory landscape is further complicated by a complex web of media ownership restrictions that artificially limit transactions and the contours of media markets. Even though media combinations are already covered by antitrust laws,[46] media properties—particularly broadcasters—were singled out for special regulation by both Congress and the FCC. These rules include the following:[47]

- *National TV Ownership Rule (TV Audience Cap)*. Networks' ownership of affiliated broadcast stations was first capped by the FCC in 1941, set at three broadcast stations.[48] Over the years, the FCC's cap permitted ownership of more than three stations.[49] In the 1996 Telecommunications Act Congress permitted networks to own TV stations that reached a combined national audience of 35 percent.[50] In 2004, Congress raised the cap to 39 percent.[51]
- *Dual Television Network Rule*. Adopted in 1946 and modified at the direction of Congress in the 1996 Telecom Act, this rule prohibits any of the top four traditional TV networks (CBS, NBC, ABC, and Fox) from affiliating with or acquiring each other.[52]
- *Local TV Multiple Ownership Rule*. Adopted in 1964, this complex rule prevents a firm from owning more than two TV stations in a designated market.

45. Adam Thierer, "CBS, Time Warner Cable & TV Blackouts: What Should Washington Do?" (August 12, 2013), Technology Liberation Front website, http://techliberation.com/2013/08/12/cbs-time-warner-cable-tv-blackouts-what-should-washington-do.
46. "The prohibitions of the Sherman Act apply to broadcasting." United States v. RCA, 358 U.S. 334 (1959). See also NBC v. United States, 319 U.S. 190, 223 (1943).
47. Federal Communications Commission, "Review of the Broadcast Ownership Rules," accessed April 28, 2014, http://www.fcc.gov/guides/review-broadcast-ownership-rules; Federal Communications Commission, "Rules Adopted in the Quadrennial Review Order," last modified Sept. 10, 2008, http://transition.fcc.gov/ownership/rules.html.
48. Broadcast Services Other than Standard Broadcast, 6 Fed. Reg. 2282, 2284–85 (May 6, 1941).
49. Stuart Minor Benjamin, "Evaluating the Federal Communications Commission's National Television Ownership Cap: What's Bad for Broadcasting Is Good for the Country," *William. & Mary Law Review* 46 (2004): 446.
50. Pub. L. No. 104-104, 110 Stat. 56.
51. Consolidated Appropriations Act, 2004, Pub. L. No. 108-199, § 629, 118 Stat. 3, 99–100 (2004) (amending section 202(c) of the 1996 Telecommunications Act).
52. 47 C.F.R. 73.658(g). See also Federal Communications Commission, In the Matter of Amendment of Section 73.658(g) of the Commission's Rules—The Dual Network Rule, MM Dkt. No. 00-108, 16 FCC Rcd 11114, 11115–16 (2001).

Further, a firm can't own two stations if the commonly owned stations are two of the top four stations in the market or the combination would leave fewer than eight independently owned stations.[53]

- *TV-Radio Cross-Ownership Ban.* Adopted in 1970, this rule limits the number of radio stations that can be owned by a TV station owner in the same market, using a sliding scale based on the number of broadcast stations in the market.[54]
- *Broadcast-Newspaper Cross-Ownership Ban.* Adopted in 1975, this rule prohibits a newspaper owner from also owning a television or radio station in the same local market.[55]
- *Cable Ownership and Affiliated Channel Caps.* The Cable Act of 1992 directed the FCC to create rules limiting the number of customers reached by a cable system and limiting the number of affiliated channels carried by a cable provider.[56] The FCC tried imposing a 30 percent cap on the market share of a cable operator, but that cap was struck down by the courts.[57] The vertical rule places a cap of 40 percent on the amount of affiliated programming cable operators could put on their own systems.[58]

A decade ago, the FCC made an attempt to pare back many of these rules during the tenure of Chairman Michael Powell.[59] The effort was met with vociferous opposition by some media access organizations mounting major grassroots efforts.[60] As a result, few of the rules were reformed and subsequent efforts to reform even individual rules have gone nowhere.[61] Meanwhile, each new proposed

53. 47 C.F.R. 73.3555(b).
54. 47 C.F.R. 73.3555(c).
55. 47 C.F.R. 73.3555(d).
56. 47 U.S.C. 533(f). When a cable operator has an "attributable interest" in a network, the FCC imposes carriage restrictions. For example, Comcast merged with NBC Universal in 2011 and now has attributable interests in MSNBC, CNBC, Bravo, and other NBC programming.
57. Comcast Corp. v. FCC, 579 F.3d 1 (DC Circuit 2009).
58. 47 C.F.R. 76.504.
59. Federal Communications Commission, In the Matter of 2002 Biennial Regulatory Review—Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996, FCC 03-127 (June 2, 2003), 4, http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-03-127A1.pdf.
60. Adam Thierer, *Media Myths: Making Sense of the Debate over Media Ownership* (Washington, DC: Progress & Freedom Foundation, 2005), 1–9, http://www.scribd.com/doc/2887203/Media-Myths-Making-Sense-of-the-Debate-over-Media-Ownership-ThiererPFF.
61. Gautham Nagesh, "FCC Withdraws Proposal to Relax Media-Ownership Rules," *Wall Street Journal,* December 16, 2013, http://online.wsj.com/news/articles/SB10001424052702303949504579262803786617112.

media combination has met with a similar backlash,[62] and these rules are invoked as a means of stopping the evolution of media markets.

LEGISLATIVE REFORM PROPOSALS IN THE 113TH CONGRESS

The following bills have been introduced in the current session of Congress to address the rapidly changing video marketplace. Some take a more comprehensive approach to video reform, but most only narrowly address one part of the complex web of rules. (Bill sponsors are noted in parentheses.)

H.R. 3720: Next Generation Television Marketplace Act (Scalise-Gardner)

Of all of the pending video bills, only the one introduced by Reps. Steve Scalise and Cory Gardner attempts comprehensive reform by peeling away the decades' worth of regulatory detritus. The bill asks all sides to give a little through the repeal of several sections of the Copyright Act and the amended 1934 Communications Act.

Under the bill, broadcasters and broadcast networks would give up retransmission and must-carry rules, but they would gain the elimination of the compulsory licensing requirements of the Copyright Act of 1976, which essentially forced a "duty to deal" upon them. They would have to let cable operators and other video distributors retransmit local stations, but the bill allows them to get full compensation for their content through marketplace bargaining.

The Next Generation Television Marketplace Act repeals seven sections of the Communications Act and eliminates various FCC regulations that distort the television market, including regulations about channel positioning, network nonduplication, syndicated exclusivity, and sports blackouts. The bill also eliminates FCC restrictions on the number of stations a person can own in the same market, the radio-television cross-ownership prohibitions, and the limitations newspaper owners face when controlling a television station.

The measure repeals must-carry requirements, which force MVPDs to carry even low-value local broadcast signals.[63] It also repeals the requirement that MVPDs pay broadcasters for retransmission rights.[64] The bill frees cable companies from section 532 of the Communications Act, which requires cable operators to set aside 10 percent or more of their channel capacity for unaffiliated programmers or affiliated minority programmers. That section also gave the FCC authority to decide what

62. Adam Thierer, "A Brief History of Media Merger Hysteria: From AOL-Time Warner to Comcast-NBC," *Progress on Point* 16, no. 25 (December 2, 2009), Progress & Freedom Foundation website, http://www.pff.org/issues-pubs/pops/2009/pop16.25-comcast-NBC-merger-madness.pdf; Adam Thierer, "A Media Morality Play," *Forbes*, December 15, 2009, http://www.forbes.com/2009/12/14/media-merger-antitrust-opinions-contributors-adam-thierer.html.
63. 47 U.S.C. § 534.
64. 47 U.S.C. § 325.

are reasonable rates and terms between programmers and cable operators. The bill prohibits all federal and state franchising authorities from regulating MVPDs' rates and the retransmission of broadcast signals.

The Copyright Office reported in its 2008 SHVERA Report that "fundamental shifts" in television viewing "call into question the appropriateness of the [compulsory] licensing systems."[65] The report went on to say that "the current distant signal licenses have served their purpose but are no longer necessary, and that Sections 111 and 119 of the [Copyright] Act have outlived their original purposes."[66] The Copyright Office's "principal recommendation is that Congress should abandon Sections 111 and 119 of the [Copyright] Act."[67] In 2010, Congress directed the Copyright Office to explore ways to phase out these compulsory licenses.[68] The Scalise-Gardner bill does just that: it repeals section 119 and amends section 111 so that market transactions can take place between MVPDs and distant broadcast networks. It also repeals section 122, which permits satellite carriers to retransmit local broadcast signals on a royalty-free basis and without authorization from the copyright holders.

S. 1680: Consumer Choice in Online Video Act (Rockefeller)

Senator Jay Rockefeller's bill, released in late 2013, proposes to "promot[e] the development of online video distribution platforms and fair competition" among all television distributors through increased oversight by the FCC. Unfortunately, the act carries over many television regulations into the nascent Internet video industry and gives the FCC substantial abilities to shape online video competition. Significantly, the bill designates a new class of businesses called online video distributors (OVDs)—like Netflix and Redbox Instant—and essentially repurposes the networks of Internet service providers (ISPs) for OVDs' benefit.

The bill lays out principles for competition and gives the FCC generous discretion to enforce those principles. For example, it is "unlawful . . . [for a designated distributor or an ISP] to engage in unfair methods of competition or unfair or deceptive acts or practices, the purpose or effect of which are to hinder significantly or prevent an [OVD] from providing video programming to consumers" including over the Internet or any device. The bill delegates rulemaking to the FCC to determine what "unfair methods" are, what "hinders significantly," and what is "deceptive."

Further, the bill instructs the FCC to prevent a distributor from "unduly or improperly influencing the decision of any other entity to make a television set or other [customer-premises equipment (CPE)] incompatible with the services provided by any

65. SHVERA Report, 19.
66. Ibid., 56.
67. Ibid., 85.
68. Satellite Television Extension and Localism Act of 2010, § 302.

[OVD]"; "unduly or improperly using its own [CPE] to discriminate against or otherwise favor its own services" over any OVD; "unduly or improperly influencing the decision of any other entity to sell, or the prices, terms, and conditions of sale of, video programming to any [OVD]"; and "providing an incentive to any entity in an attempt to deny video programming to an [OVD]." All the operative words in these sections are left to the discretion of the FCC. An aggressive FCC could use these provisions to radically shape commercial contracts and television competition.

The bill provides the FCC with a process to review any contract between MVPDs, programmers, and OVDs. Ironically, all these contracting costs would only encourage vertical mergers (subject to existing media ownership restrictions). Mergers between traditional distributors, online distributors, and programmers would substantially lower transaction costs that this bill imposes. Absent a merger, most firms would face severe regulatory risks since the FCC is injected into nearly every agreement between content producers and distributors.

Broadcasters would be penalized in this bill because they would be required to negotiate with OVDs under rules a future FCC would issue. Broadcasters also would not be allowed to place any restriction on an OVD's distribution to subscribers. The bill blesses the existence of antenna rental services, like Aereo, as long as they only serve local broadcasts to the respective local area, and it exempts those services from paying retransmission fees.

The bill essentially implements net neutrality on Internet service providers when they deal with OVDs. ISPs could not block, degrade, or unreasonably discriminate against OVDs; nor could they provide transmission benefits to affiliated OVDs. ISPs would also be prohibited from usage-based billing that deters competition from unaffiliated OVDs. During disputes in this new television market, the FCC would be able to establish prices, terms, and conditions of sale of programming to OVDs.

In addition to cable and satellite companies, the bill introduces another regulatory silo: a non-facilities-based MVPD (NFB MVPD). If an OVD provides programming reasonably equivalent to an MVPD, the OVD could elect to be treated as a non-facilities-based MVPD. This election would bring many of the existing television regulations onto this new market participant, but it would exempt the NFB MVPD from others. The FCC could decide what MVPD regulations should apply to NFB MVPDs, guided by its public interest standard. There are some requirements, though.

NFB MVPDs would have to allow a reasonable amount of time for candidates for federal office and, if one allows a candidate to use its facilities, it would have to allow all eligible candidates to use its facilities. NFB MVPDs would be exempt from complying with "basic tier and tier buy-through" requirements. They could also carry nonlocal broadcasts. They would be exempt from network nonduplication, syndicated exclusivity, and sports blackout rules. They would also be exempt from any franchising authority. They could not be required to carry local broadcasts as a condition of carrying nonlocal broadcasts. NFB MVPDs that carry local signals would have to carry, upon request, noncommercial educational broadcast signals in the same local area. They would have channel reservation requirements. They would have to reserve between 3.5 and 7 percent of channel capacity for educational and informational programming. They would also have to make channel capacity available to each national educational programmer at reasonable prices and terms. Finally, NFB MVPDs carrying any broadcast signal would be considered a "cable system" and thus subject to compulsory licensing requirements and royalty payments. Oddly, NFB MVPD–subscribing households could not be considered in the FCC's determination of whether a traditional cable system would be subject to effective competition in that franchise area.

H.R. 3719: The Video Choice Act (Eshoo)

Rep. Anna Eshoo's bill limits itself mostly to retransmission disputes, which are disruptive for consumers. In a retransmission negotiation impasse, the bill allows the FCC to permit the MVPD's interim carriage of the broadcast station pending conclusion of the impasse.

The bill also contains an anti-tying—or an a la carte—provision. A broadcaster that grants retransmission could not enter into an agreement with an MVPD that in any way conditions carriage of popular retransmission programming on carriage of other, less popular programming. Cable operators would have to offer subscribers a separate tier (called the retransmission consent tier) consisting only of broadcast signals. This tier would be subject to rate regulation, the same as the basic cable service tier. A cable operator could not require purchase of any tier, other than the basic cable service tier, to receive the retransmission consent tier. In telecom-speak, this is a buy-through prohibition.

The Video Choice Act focuses on important consumer issues—the disruptiveness of retransmission disputes and the relatively high cost of cable packages. However, the bill attempts to remedy the symptoms of flawed video markets, not the causes. At this time, retransmission fights are complicated by the fact that network nonduplication and syndicated exclusivity rules prevent cable companies from contracting with other broadcasters at impasse. And cable packages are expensive bundles in part because the FCC and Congress have mandated the carriage of broadcast content; public, educational, and governmental (PEG) channels; and nonaffiliated content in every cable package. This bill only adds more complexity—including price controls of the retransmission consent tier—to television markets.

S. 1721: Furthering Access and Networks for Sports (FANS) Act (Blumenthal-McCain)

In November 2013, Sens. Richard Blumenthal and John McCain introduced the Furthering Access and Networks for Sports Act. In short, the act eliminates the

FCC's sports blackout rules. Sports leagues currently have a limited antitrust exemption under the Sports Broadcasting Act, in place since 1961.[69] This bill would once again extend antitrust laws to leagues and distributors that prohibit distribution in the home territory of the home team.

For leagues to enjoy the current antitrust exemptions of the Sports Broadcasting Act, the league would have to prohibit any television licensee from deliberately removing sports games from a cable or satellite distributor during distribution contract negotiations. A league would also have to make a game available, for a fee or otherwise, over the Internet when a game is not available via television through broadcasters or pay TV.

Removing the sports blackout rules would be beneficial as the rules prevent bargaining between pay-TV operators and major sports leagues. Removing the limited antitrust exemption that sports leagues currently enjoy is also commended since the exemption is a special-interest concession.[70] Conditioning the exemption on the leagues' efforts to make games available to MVPDs during retransmission negotiations, however, would only threaten the leagues with an ill-conceived antitrust exemption.

S. 1912: The Television Consumer Freedom Act (McCain)

Sen. John McCain for years has attempted to bring some a la carte channels to the television market. This act withholds some regulatory benefits if a distributor does not make its content available a la carte. The bill rescinds the benefit of the statutory compulsory license fees for MVPDs if they do not offer retransmitted channels to consumers on an a la carte basis. Again, this piecemeal legislation has the potential to distort television markets further. A simpler solution might be to remove the requirement that MVPDs carry retransmitted broadcasts on their basic tiers.

To further promote a la carte programming, the bill also rescinds regulatory benefits to broadcasters. The bill provides that a broadcaster may not elect retransmission fees or avail itself of network nonduplication and syndicated exclusivity rules if the station is not made available to MVPDs on an a la carte basis. Finally, program vendors—like Viacom and Time Warner—could only offer program bundles to distributors if they also offer programming on an a la carte basis. Bundling programs is generally economically efficient[71] so a requirement to unbundle is counterproductive.

69. 15 U.S.C. 1291.

70. We would, however, predict little impact from removing the exemption because antitrust law has changed considerably since the time the exemption was granted. It is unlikely the antitrust agencies could support a lawsuit against the leagues under current economic theories of harm.

71. David S. Evans and Michael Salinger, "Why Do Firms Bundle and Tie? Evidence from Competitive Markets and Implications for Tying Law," *Yale Journal on Regulation* 22, no. 1 (2005): 37–89.

CONCLUSION

Regulatory reform is needed to clear out the regulatory detritus of the past half century because current regulations limit market opportunities for existing media providers. If the current rules are maintained or extended, future content creators and distributors will be stymied. It is discouraging that most of the bills that Congress is contemplating offer only marginal improvements or actually burden the marketplace with more regulations. What is needed is more comprehensive reform. Such a legislative solution would declutter the modern legal landscape for media and give media innovators the freedom to experiment. It would be counterproductive to expand regulation of the video marketplace and set back needed liberalization efforts.

Repealing outdated video marketplace regulations from the analog era will lead to even more experimentation with new business models, technologies, and methods of content creation and delivery. We already see much innovation in this marketplace despite all the red tape.[72] As noted earlier, many alternative video delivery platforms exist today. Broadcast and cable giants have made strides in recent years, too. CBS is a good model for how to repurpose online content in creative ways on a firm's own digital platform. Likewise, Walt Disney has effectively utilized the combination of its ABC and ESPN properties to offer consumers a seamless sports experience across broadcast, cable, and Internet platforms. Meanwhile, cable companies like Time Warner Cable are adapting to consumers' demand that video be delivered to multiple devices. Finally, innovation from online platforms—such as Internet giants Amazon, Apple, Google, and Microsoft, among others—continues at a healthy clip.

A deregulated market is not a nirvana, of course. Some regulatory activists seemingly expect that media content can be delivered effortlessly and cheaply, but it is complicated to get that content financed and distributed in the first place. Great content and great delivery platforms do not just happen by magic or through the good intentions of activists or policymakers. That content and those platforms come about because new markets and monetization mechanisms develop to facilitate them. Comprehensive liberalization of America's video marketplace can help ensure that more media content is developed and distributed going forward.

72. Adam Thierer, "Television: From Vast Wasteland to Vast Wonders," *Forbes*, May 16, 2011, http://www.forbes.com/sites/adamthierer/2011/05/16/television-from-vast-wasteland-to-vast-wonders.