Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming	)))	MB Docket No. 17-214

EX PARTE RESPONSE

The American Cable Association hereby responds to the reply comments filed by Comcast Corporation and NBC Universal, LLC ("Comcast").[1] In this response, we first present additional information about the harms of vertical integration and explain why the Commission should address such harms, notwithstanding Comcast's claims to the contrary. We then address Comcast's defense of how it formulates its minimum penetration requirements.

In our initial comments,[2] we described how vertically integrated programmers like Comcast can harm rival multichannel video programming distributors ("MVPDs"), including ACA's small- and mid-sized cable operator members—notwithstanding the

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1 Reply Comments of Comcast Corp. and NBCUniversal Media, LLC, MB Docket No. 17-124 (filed Nov. 9, 2017) ("Comcast Reply").

2 Comments of the American Cable Association, MB Docket No. 17-214 (filed Oct. 10, 2017) ("ACA Comments").

recent growth of online programming options. We described in particular reports by ACA members that Comcast's regional sports networks ("RSNs") combine high minimum penetration requirements with a refusal to grant exceptions to those requirements for subscribers to the broadcast basic servicer tier.[3] This combination of requirements have prevented these ACA members from broadly offering their customers the opportunity to purchase a low-priced broadcast basic tier of service.[4] We urged the Commission to remain vigilant in protecting consumers and to reject claims that "the market" alone will do so. More specifically, we suggested, among other things, amending the program access rules.[5]

In response, Comcast takes issue with our characterizations of vertical integration generally and Comcast's own actions specifically. It argues that programmers have good reason to seek and enforce minimum penetration requirements regardless of vertical integration.[6] And it argues that it does not insist on near-universal RSN penetration in order to harm its MVPD rivals—as evidenced by the fact that ACA members have not sought arbitration under the *Comcast-NBCU*

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[3] ACA Comments at 7.

[4] *Id*.

[5] *Id.* at 5. ACA suggested that the Commission update its definition of a buying group so that the National Cable Television Cooperative (NCTC) would qualify. We have also recommended parallel changes to the "good faith" negotiation rules to address vertical integration concerns. Comments of the American Cable Association at 14, MB Docket No. 15-216 (filed Dec. 1, 2015) (arguing that a broadcaster violates its obligation to negotiation retransmission consent agreements in "good faith" if it insists on bundling signals with RSNs or other "must-have" programming, or if an MVPD-affiliated broadcaster discriminates based on vertical competitive effects).

[6] Comcast Reply at 3-4.

conditions.[7] Thus, concludes Comcast, the Commission should do precisely nothing to address vertical integration: it should not amend the program access rules, and it should not investigate Comcast's penetration requirements.[8]

We think Comcast is wrong. And we think Comcast's position on vertical integration is impossible to reconcile with the view recently expressed by the Department of Justice in AT&T-Time Warner merger.[9] Below, we explain in more detail why vertical integration should concern the Commission—and why the fact that ACA members have not sought arbitration under the *Comcast-NBCU* conditions suggests that the conditions have worked exactly as intended. We then respond to Comcast's specific claims about its penetration requirements. While penetration requirements *generally* may be widespread, we are concerned about Comcast's *particular* formulation.

I. VERTICAL INTEGRATION CONTINUES TO HARM CONSUMERS AND COMPETITION, NOTWITHSTANDING MARKET CHANGES.

In its initial comments, ACA focused on the continuing need for the Commission to enforce program access rules and to otherwise moderate incentives that vertically integrated video distributors have to disadvantage rival distributors.[10] Congress and the Commission have long recognized both that competition between video distributors benefits consumers and that vertical integration between a video distributor and

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[7] *Id.* at 6-7; *Comcast Corp., General Elec. Co. and NBC Universal, Inc.*, 26 FCC Rcd. 4238, App. A (2011) ("*Comcast-NBCU Order*").

[8] Comcast Reply at 7-8.

[9] Complaint, *United States v. AT&T Inc.*, No. 17-02511 (D.D.C. Nov. 20, 2017) ("DOJ Complaint") available at https://www.justice.gov/opa/press-release/file/1012896/download.

[10] ACA Comments at 1-6.

programmer can potentially damage this competition and thus harm consumers.[11] This is because a vertically integrated firm has both the incentive and ability to disadvantage rival distributors by either raising the prices its charges these rivals for programming or withholding this programing from them altogether.[12]

Since ACA filed its comments, the Department of Justice reiterated the importance and significance of these competitive effects by filing to block the proposed vertical merger between AT&T and Time Warner Entertainment.[13] As DOJ explained, while online offerings can provide needed competition to vertically integrated programmers, such offerings can actually *increase* the incentives of such programmers to engage in anticompetitive behavior.[14]

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[11] *See, e.g.*, 47 U.S.C. § 548; 47 C.F.R. §§ 76.1001-04 (program access rules); *General Motors Corp., Hughes Elecs. Corp., and The News Corp. Ltd.*, 19 FCC Rcd. 473 (2004) ("*News Corp-DIRECTV Order*"); *Adelphia Communications Corporation and Time Warner Cable Inc.* 21 FCC Rcd. 8203 (2006) ("*Adelphia Order*"); *Comcast-NBCU Order*.

[12] *E.g.*, *Comcast-NBCU Order* ¶¶ 28-124.

[13] DOJ Complaint at 1-2 ("As AT&T has expressly recognized, however, distributors that control popular programming 'have the incentive and ability to use (and indeed have used whenever and wherever they can) that control as a weapon to hinder competition.' Specifically, as DirecTV has explained, such vertically integrated programmers 'can much more credibly threaten to withhold programming from rival [distributors]' and can 'use such threats to demand higher prices and more favorable terms.' Accordingly, were this merger allowed to proceed, the newly combined firm likely would—just as AT&T/DirecTV has already predicted—use its control of Time Warner's popular programming as a weapon to harm competition. AT&T/DirecTV would hinder its rivals by forcing them to pay hundreds of millions of dollars more per year for Time Warner's networks, and it would use its increased power to slow the industry's transition to new and exciting video distribution models that provide greater choice for consumers. The proposed merger would result in fewer innovative offerings and higher bills for American families.").

[14] DOJ Complaint at 6 (asserting that the proposed merger "would enable the merged company to impede disruptive competition from online video distributors—competition that has allowed consumers greater choices at cheaper prices.").

Of course, the most significant combination of video distribution and programming is that between Comcast and NBC Universal. In addition to being the nation's largest cable operator, Comcast controls access to significant programing that—as the Commission has found[15]—its rivals must have in order to compete with it. This "must have" programming includes NBC owned and operated local television stations, the bundle of extremely popular national cable programming networks controlled by NBCU, and, in many regions of country, RSNs that hold exclusive rights to carry local and regional sports events.

By any reasonable measure, the programming controlled by Comcast is at least as "must have" as the programming that AT&T would acquire under its proposed merger with Time Warner. The major broadcast networks and RSNs are widely acknowledged to be among the most essential networks that distributors must carry in order to attract subscribers.[16] The bundle of Turner programming that AT&T proposes to purchase contains neither. Thus the concerns that DOJ has expressed over the incentive and ability that a merged AT&T-Time Warner would have to disadvantage rivals apply *a fortiori* to Comcast.

While it may be too late to attempt to "unscramble" the Comcast-NBCU merger, the Commission must nonetheless ensure that competition in video distribution markets

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15 *Comcast-NBCU Order* ¶ 36 ("[L]oss of Comcast-NBCU programming ... would harm rival video distributors, reducing their ability or incentive to compete with Comcast for subscribers. This is particularly true for marquee programming, which includes a broad portfolio of national cable programming in addition to RSN and local broadcast programming; such programming is important to Comcast's competitors and without good substitutes from other sources.").

16 *See id.* ¶ 37.

occurs on a level playing field. As ACA explained in its initial filing, while program access rules provide some protection to competition, the additional conditions placed on Comcast when the Commission approved the Comcast-NBCU transaction provide significant additional protection.[17] The extent to which Comcast controls "must have" programming has not changed in last seven years. Therefore, the need for Commission vigilance is just as high now as when the transaction was originally approved. The Commission should seek ways to to ensure that expiration of the *Comcast-NBCU* conditions do not harm competition—including by examining whether an arbitration remedy should be made available under the program access rules.

Comcast's principal response to this is to posit that vertical integration is not a problem because ACA members have not sought arbitration under the *Comcast-NBCU* conditions.[18] This, argues Comcast, constitutes proof that those conditions are no longer necessary—if they ever were necessary.[19] Nonsense. If anything, the absence of arbitration indicates that the conditions worked as intended. Providing MVPDs with the ability to threaten to ask for arbitration if negotiations fail to produce reasonable terms can impact the terms that are negotiated even if the threat is never exercised. Arbitration, moreover, is expensive and time-consuming for all parties. We would thus generally expect rational parties to be able to agree to terms that an arbitrator would find to be reasonable without distributors actually ever having to actually invoke the

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[17] ACA Comments at 4 (citing *Comcast-NBCU Order* App. A).

[18] Comcast Reply at 7.

[19] *Id.* (arguing that ACA's advocacy "rings hollow").

arbitration condition. This is precisely what such a condition is designed to do.[20] And this, in fact, is what happened: as ACA described in its initial comments, NCTC *did* explicitly threaten to ask for arbitration unless Comcast offered more reasonable terms—and Comcast ultimately responded by offering more reasonable terms.[21]

II. COMCAST'S DEFENSE OF ITS RSN PENETRATION REQUIREMENTS IS UNAVAILING.

In our initial comments, we described how Comcast insists on extraordinarily stringent minimum penetration requirements for its RSNs.[22] As we noted, almost all programmers include some minimum penetration requirements in their licensing agreements to assure broad distribution of their programming. The effect of these practices has been to require MVPDs to offer a bundle of 50 or more cable programming networks in the so-called "expanded basic" tier that is essentially indivisible in the sense that a consumer must buy the entire bundle to have access to any single cable programming network. The major exception to this programmer-imposed rule that all MVPD subscribers must purchase the super-sized expanded basic tier is that cable programmers effectively have permitted MVPDs to offer their subscribers stand-alone access to a much smaller bundle consisting primarily of broadcast channels (the so-called "broadcast basic" tier) at a significantly lower price by

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[20] *See, e.g.*, *News Corp-DIRECTV Order* ¶ 174 ("Our arbitration condition is also intended to push the parties towards agreement prior to a complete breakdown in negotiations. Final offer arbitration has the attractive 'ability to induce two sides to reach their own agreement, lest they risk the possibility that a relatively extreme offer of the other side may be selected by the arbitrator.'").

[21] ACA Comments at 10 (citing NCTC negotiations with Comcast).

[22] *Id.* at 8-9.

not including subscribers in this tier in their minimum penetration requirements.[23] This option has always been attractive to the most price sensitive viewers. However, the skinny bundle has recently begun to grow in popularity as more on-demand video programming and cable networks have become available from online video distributors over the Internet.[24]

In our initial comments we noted reports from several members—operators that both carry Comcast programming and that compete with Comcast's cable service—that Comcast has sought to interfere with their attempts to broadly sell a broadcast basic tier of service at low prices. Specifically, they report that, in its RSN licensing agreements with them, Comcast has insisted on including a minimum penetration rate requirement that does not incorporate a broadcast basic exclusion and on setting the minimum penetration rate at a high enough level such that these members are no longer able to broadly sell a broadcast basic tier of service at their existing prices without automatically

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[23] Many programmers completely exclude broadcast basic subscribers from penetration requirements. In this case even a required penetration rate of 100% will not interfere with an MVPD's ability to sell broadcast basic service to those customers that prefer this service. Even programmers that do not completely exclude broadcast basic subscribers from their penetration requirements have generally either set the minimum penetration rate at a low enough level and/or allowed partial exclusion of broadcast basic subscribers so as not to constrain MVPDs' ability to sell broadcast basic service to as many customers as wish to purchase this service. For example suppose that 17% of an MVPD's customers wish to purchase broadcast basic service given the price at which this service is offered. A minimum penetration rate of even 100% with a complete broadcast basic exclusion would not constrain the MVPD. However, a minimum penetration rate of 80% with no broadcast basic exclusion would also leave the MVPD unconstrained. Finally, a minimum penetration rate of 85% that allowed the MVPD to exclude up to 6% or its subscribers that were basic broadcast subscribers would also leave the MVPD unconstrained. In this last case, the MVPD's penetration rate for purposes of the penetration requirement would be (83/94) x 100% or 88% which exceeds the minimum rate of 85%. In all three cases, the result is that the licensing agreement does not restrict the ability of the MVPD to sell broadcast basic service to those customers wishing to purchase this service.

[24] ACA Comments at 7.

violating the minimum penetration requirements. In particular, the requirements are so stringent that these members automatically violate them even when they include the RSN in every video bundle they sell except for the broadcast basic bundle. Thus, these ACA members must either raise the price of the broadcast basic tier to dampen demand for this service, or essentially cease to offer a true basic broadcast tier that does not include cable programming networks. Either outcome obviously limits the ability of these ACA members to compete with Comcast's own cable offerings. These outcomes also harm subscribers by increasing the prices they pay and/or limiting the choices they have.

Comcast's principal response is to defend penetration requirements *generally*—a practice in which, Comcast argues, all programmers engage to achieve broad distribution.[25] Of course, ACA has taken issue with programmers' abuse of minimum penetration requirements more generally, and would urge the Commission to examine these issues.[26] With respect to Comcast's minimum penetration requirements, however, ACA makes a more specific and limited point: *Comcast* appears to formulate its minimum penetration requirements in a way that causes particularized harm.[27]

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[25] Comcast Reply at 2 (penetration requirement is a "standard industry requirement for MVPDs and OVDs to commit to broadly distribute this programming").

[26] ACA Comments at 7; *see also* Comments of the American Cable Association at 26-28, MB Docket No. 16-41 (filed Mar. 30, 2016) ("ACA 2016 Independent Programming NOI Comments").

[27] The sources cited by Comcast do not suggest otherwise. For example, Comcast cites the following statement from a group of programmers: "[F]avorable tier placement and penetration thresholds help make program channels more attractive to advertisers, which in turn gives programmers access to revenue while they build out their audience base. Minimum penetration and tier placement guarantees also comprise part of the consideration programmers exchange when negotiating license fees. The absence of such commitments effectively gives MVPDs the discretion to relocate an independent network to a less penetrated tier or drop the network altogether, which deprives the independent programmer

If Comcast is suggesting that it can *only* achieve broad distribution by applying high minimum penetration requirements to basic tier subscribers, our answer is that other programmers don't seem to share this view. And we do not understand how such a claim could be correct. A 100 percent penetration requirement with a broadcast basic exclusion would ensure that a network was distributed to all of an MVPD's subscribers except for their broadcast basic subscribers. Yet ACA's members tell it that most programmers set minimum penetration rates *lower* than 100 percent, even though they allow a basic broadcast exclusion. The intent of most programmers appears to be to guarantee that their most popular programming is placed on the so-called expanded basic tier. Using minimum penetration rates less than 100 percent with a broadcast basic exclusion is sufficient to accomplish this.

If, as we believe, Comcast can obtain relatively broad distribution without formulating minimum penetration requirements as it does, something else may be going on here. It may be no coincidence that the programmer most aggressively seeking to restrict ACA members' attempts to broadly sell a basic broadcast tier at low prices is the programmer with especially high levels of vertical integration. Unlike non-vertically integrated programmers, Comcast has broader interests than simply ensuring that its programming is broadly distributed. It also wishes to protect and enhance the profits it earns as a cable operator.[28]

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of the benefit of its bargain." Reply Comments of CBS Corporation, The Walt Disney Company, Time Warner Inc., 21st Century Fox, Inc., and Viacom, Inc. at 5, MB Docket No. 16-41 (filed Apr. 19, 2016) (citations omitted). This statement, however, says nothing about the broadcast basic tier.

[28] *See Comcast-NBCU Order* ¶ 44 (concluding that an "anticompetitive exclusionary program access strategy would often be profitable for Comcast").

More specifically, we see at least two possible reasons why Comcast might find it advantageous to limit that ability of other MVPDs to sell a broadcast basic tier at low prices. First, and most obviously, Comcast may be competing to sell the same service or a close substitute service to consumers and simply wishes to disadvantage its direct rivals. However, Comcast's motives may be more subtle than this. For example, it may be that the availability of a broadcast basic tier at low prices encourages "cord shaving" and makes OVDs a more attractive option, and Comcast's motive may be to preserve the existing profit stream from the traditional expanded basic video bundle for as long as possible. ACA's members generally earn much lower profit margins on traditional MVPD service than do larger MVPDs such as Comcast, because they pay much higher license fees.[29] Thus ACA's members have a much smaller stake in attempting to preserve the *status quo* where almost all video subscribers purchase the bloated expanded basic bundle and have stronger incentives to compete by offering customers smaller bundles of programming if this is what they want.

Whichever of these motives drive Comcast's actions, the fact remains that Comcast appears to have decided to adopt restrictive licensing practices that prevent some ACA members from offering a broadcast basic tier to its subscribers at low prices. The Commission should consider investigating issues related to minimum penetration requirements generally and Comcast's practices specifically that have the effect of limiting MVPDs' ability to broadly sell a broadcast basic tier to their subscribers at low prices. ACA believes that, upon such investigation the Commission will conclude that

[29] *See* ACA 2016 Independent Programming NOI Comments at 2.

these practices unreasonably restrict consumer choice without providing any offsetting benefits.

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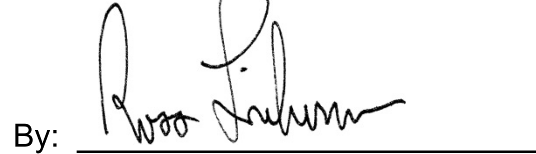
The Commission must remain vigilant to counteract the incentives that vertically integrated programmers have to harm their rivals. It should take actions, as described herein, to ensure that competition between video distributors thus occurs on a level playing field.

Respectfully submitted,

AMERICAN CABLE ASSOCIATION



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December 7, 2017