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Hearing on Competition in the Video Marketplace

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INTRODUCTION

Thank you, Mr. Chairman and members of the Committee. My name is Patrick Knorr, and I am the Chief Operating Officer of Sunflower Broadband and immediate past Chairman of the American Cable Association (ACA). ACA represents nearly 1,000 smaller and medium-sized cable companies providing advanced video, high-speed Internet access and telephone service in predominantly rural and smaller markets in every state.

As small and medium-sized independent cable operators, we represent a unique perspective on the pay-television marketplace. Our members often invest in communities where the 'big guys' find it unattractive to provide service, whether that is in rural communities such as Onaway, Michigan, and Stowe, Vermont, or in more urban markets such as Springfield, Illinois, and Boise, Idaho. ACA members have built these networks in the most rural areas of our country without any direct federal subsidy and in the face of federal rules that make negotiations for select services extremely difficult.

KEY ISSUES

But what should concern you today as you look forward is the following. First, while all of our costs to expand our service offerings continue to grow, one cost has grown exponentially over the past few years, and that's the cost of programming. It is also the primary reason that the cost of video services continues to rise. Consumers are unaware of the underlying cost of programming, and they do not understand why they have so few options in how programming is packaged.

Right now there is no way for you as Members of this Committee, or for the Federal Communications Commission -- or even the public for that matter, to see what we pay for the content we carry. That, too, is a problem. The non-disclosure terms of our contracts, added at the behest of the programmers, prohibit that information from being shared. This veil of secrecy ensures consumers are confused, policymakers are left in the dark and programmers are free to charge whatever they like with little regard or fear from competition. You would be shocked to know what we have to bill our consumers for some channels; and the discrepancy in cost of carriage between small and large operators would be more alarming.

The most illuminating example of this is sports programming. The amount our customers pay for sports programming, whether they watch it or not, is a significant percentage of their overall cable bill. For this reason, I think you should require transparency for the cost of carriage on a per-channel basis of sports programming channels so consumers are aware of what they are paying for these channels and to expose disparities between small and large distributors. We also believe some competition needs to be injected into the marketplace. Currently, there are no market forces that set the rate for content.

Second, flaws in the subscriber-television model are being transferred to the Internet and will be too difficult to undo if they are hard-baked into the building blocks of that distribution environment as well.

The best example of how the marketplace has evolved in distributing content involves following the trail of a single show. In this case, I would highlight ABC's "Lost." This popular program is distributed a number of ways: (1) via cable and satellite distributors whose consumers have paid a subscription for service; (2) via iTunes where consumers can purchase an episode or an entire season uninterrupted by advertisements and "own" the programming; and (3) via the Internet where they can watch it over a streaming service on ABC's Web site. The Communications Act was developed to address the first scenario, but has yet to be updated to address the issues raised by the collision of these new distribution models.

What confronts us is the basic public policy discussion of what happens now? As consumers watch more and more video via iPods and the Internet, should I as a cable operator have to pay non-market-based rates for a product that was originally supposed to be exclusively distributed by my local broadcaster and is protected by federal laws because of that exclusivity? What happens to localism when my local broadcaster is also being by-passed by the network that is now offering that valuable prime time signal directly to consumers at any time of the day and ensuring that they will not see the local advertisements that the local broadcaster depends upon to stay viable?

Should I care about whether someone has watched the show as a cable stream versus as a Web stream or should I just bill them for whatever amount of bits they have used to view that program? In short, I believe that the rules created in 1992 and 1996 to govern the television market are antiquated and long overdue for reform. They are inadequate and do not reflect the realities of the

Internet and the impact of pervasive consolidation in the media industry that has occurred since those rules were put in place.

As you can see, there are profound issues at play. Congress needs to consider how to protect and promote localism, expand the varieties of television offerings consumers can purchase, increase transparency in the process, and help companies like mine understand how to stay in business in order to offer the cable and broadband service in rural America that Congress so desperately wants deployed.

UNIQUE CHALLENGES

As small operators with systems that typically serve fewer than 5,000 subscribers, we face challenges that just don't affect our larger brethren. Over the years, we have discussed our concerns regarding the rules governing retransmission consent, and I will touch on that again today. Current retransmission consent rules fail to reflect the overwhelming market power small operators face when dealing with the media cartels. In fact, since we typical bring service to areas that would not otherwise receive the broadcast signal over the air, it galls many of us that today's negotiations completely ignore the value provided by smaller cable operators to rural America to expand the reach of broadcasters' signals and the high cost of delivering service in hard-to-reach areas.

Adding insult to injury, this system typically results in broadcasters charging us, and therefore your constituents, far more than the larger service providers, just to receive the same signal. This leaves consumers of smaller cable systems paying more for the same content that urban viewers get at a lower rate even though it costs the same amount to deliver the signal to a large or small operation. To be clear: what happens today is not a "negotiation."

A typical ACA member has only a few thousand subscribers, which is relatively inconsequential to a broadcaster's bottom line. Often, our systems will not affect Nielsen ratings whether we are or are not included in its viewership totals. As a result, ACA members often do not even get calls back to negotiate retransmission consent when we seek to discuss rates. Instead, we receive take-it-or-leave-it offers. This is not what one thinks of as a competitive marketplace. In the end, the rural consumer is harmed by having to pay higher rates. This anti-competitive structure makes it nearly impossible to price our service offerings at a competitive rate when we are paying in some cases ten times more than the competition is paying – FOR THE SAME CONTENT.

It's a broadcaster-to-MVPD negotiation, and that is limited to the one broadcaster per network with whom I am allowed to negotiate. If broadcasters name a price I find outrageous, I do not have the luxury of going elsewhere in search of better options for my customers. Instead, I have the option to take the channel and raise my rates or drop the channel and risk upsetting subscribers who prefer to have the channel.

In a media market dominated by consolidated conglomerates, there is no way for a small cable operator to have any leverage in negotiations. Providing a vital service for the areas they serve, small cable operators should not be discriminated against because of their size. Because small

operators face such unique challenges under the regulatory regime in place, perhaps it would just make more sense to treat such systems differently from larger companies. Earlier this year, a Clarus Research Group survey of ACA members found that cash retransmission consent costs shot up 271% from 2008 to 2009, and that small systems with 1,000 subscribers or fewer got hit with increases that were 200% higher than the increases experienced by systems with 25,000 subscribers or more.

MVPD's should have at least some right to shop for retransmission consent in neighboring markets to see what kind of rate they can get for their customers. If they do not like the channel we have chosen to carry, they have the option to go to another MVPD that is still carrying the network assigned to the Designated Market Area and pay whatever price has been set. All I really want is to be able to make decisions to offer a suite of programming for my customers that is tailored by my knowledge of what they like to view and what price I believe they are willing to pay. Therefore, give me the tools that you give most every other businessman in America: the right to respond correctly to the desires of my customers and succeed at business while fearing the reality of responding incorrectly and watching my customers flock to my competitors.

REGULATIONS FAVOR BROADCASTING

Let me back up and remind you how the government has enabled this anti-competitive behavior. The retransmission consent/must-carry regime was established in the Cable Act in 1992. Retransmission consent allows a broadcaster to demand payment for retransmission of his signal that is broadcast on public airwaves, and is freely available to over-the-air consumers. A cable operator cannot carry the signal until it has successfully negotiated a retransmission consent deal. On the other side of the fulcrum is must-carry. Should the broadcaster decide he doesn't want to demand a fee but rather demand carriage, he can do that too.

So Congress has put the broadcaster in a position that guarantees both profit and carriage. In addition, broadcasters have market exclusivity, meaning they are the only game in town in their DMA. This creates a monopoly for the broadcaster because a cable operator cannot go outside of his DMA to get a less expensive station (and in many cases a "more local" in-state signal). Cable operators must adhere to the terms of carriage for their in-market signal or not offer the channel at all. On top of that rule is another called network non-duplication, which prohibits two of the same networks being carried in the same market. All of this regulation is in place to protect the broadcaster's exclusive control in its DMA and is not designed to protect consumers, control costs, or create competition.

ESPN360'S INTERNET BUSINESS MODEL

Let's also fast forward from the 1992 Cable Act to study how programming is migrating from the cable platform to the Internet and what ramifications that can have for consumers. I would state that unless the rules evolve, programmers will find ways to profit from this arcane cable regulatory model by hiding the costs of service from consumers behind artificial walls. Take ESPN360 for example. According to its own statements, ESPN360, owned by the Walt Disney Co., is pioneering a closed Internet business model, under which broadband service providers must pay ESPN fees

based on their total number of broadband subscribers, forcing those who have no interest in viewing sporting contests over the Internet to subsidize those who actually want to access ESPN360 on a regular basis.

Despite the technological ability to provide this content directly to subscribers for a fee, ESPN has elected to block access to this Web content unless a provider agrees to place this burden on all its broadband customers. ESPN, the largest and most dominant sports programming business in the country, uses its leverage in the satellite and cable marketplace and its control over unique sports programming to coerce broadband service providers into giving ESPN360 preferential treatment on their networks at the expense of consumers on the one hand and other Web-based services and applications that might seek to compete against them on the other. How can a Web-based sports site fairly compete against ESPN on the Internet when ESPN has secured for itself a substantial per-subscriber fee from every broadband customer in the country?

We believe that content distributors should live under the same Net Neutrality rules as broadband service providers. Therefore, we would request that if you are to proceed in addressing Net Neutrality legislation that you do not focus just on network service providers, but ensure that restrictions also pertain to content providers that limit consumer access to content on a network level as well. Consumers should be given a choice and a chance to access any legal content on the Internet. We don't oppose subscription-based Web sites as long as the consumer has the choice to pay for that subscription. But we do believe that attempts to 'cable-ize' the Internet by making everyone pay for access to a Web site that only a few will visit is contrary to the public interest.

In discussing the responsibilities of ISPs going forward, ACA believes a fair balance allows broadband providers to manage their networks effectively while permitting consumers to access legal content of their choice. If regulators continue to let media conglomerates increase their control of content, retail price problems that we've seen in the cable industry will be exacerbated on the Internet.

SOLUTIONS

1. The current retransmission consent and broadcast exclusivity laws and regulations limit consumer choice and impede smaller, independent cable operators' ability to compete in smaller markets and rural America by permitting distant media conglomerates to charge monopoly prices for programming. This situation must not be carried forward into the post-DTV transition world and there are some specific solutions you should adopt: Prohibit any party, including a network, from preventing a broadcast station outside of the local market from granting retransmission consent to a smaller cable company outside of the protected zone.

2. In order to combat the problems of vertical integration, apply Fox/DirecTV merger conditions to retransmission consent, including (i) a streamlined arbitration process; (ii) the ability to carry signals pending dispute resolution; and (iii) automatic retransmission consent for smaller cable.

3. Address the challenge of providing local digital signals for rural markets by granting cable access to local-into-local DBS television signals on non-discriminatory rates, terms and conditions.

4. Congress should ensure programming pricing fairness for smaller cable companies. Because of the unique value of programming and inherent monopolistic market power that content holders have for programming and retransmission consent, Congress should ensure that all programming should be provided to all small cable operators with non-exclusive, standardized rates, terms and conditions.

5. Authorize a confidential review of retransmission consent and cable programming rates, terms and conditions and release aggregate data and trends yearly, similar to what is done on overall cable rates by the FCC.

6. All sports programming prices, terms and conditions charged to cable operators should be publicly available to Congress, the FCC and consumers.

7. Provide parity with DBS that would permit small cable operators to offer local broadcast programming in its own tier as an optional purchase.

8. In discussing the responsibilities of ISPs going forward, ACA believes a fair balance allows broadband providers to manage their networks effectively while permitting consumers to access legal content of their choice. If regulators continue to let media conglomerates increase their control of content, retail price problems that we've seen in the cable industry will be exacerbated on the Internet. Providers of Internet content, services and applications should not be allowed to block consumer's access to their products simply because ISPs have not signed contracts with these companies.

9. Allowing ISPs to pursue consumption billing will promote affordable broadband access for every American. Flat-rate pricing plans wrongly allow the network's heaviest users to transfer their costs to light and moderate users, and they also require network upgrade costs to be recovered from all subscribers equally. As economists Kevin Hassett and Robert Shapiro explained in a recent paper released in association with Georgetown University, reliance on flat-rate plans drives up the cost of broadband for everyone and makes it harder for the most price-sensitive consumers on the lower end of the income scale to buy a broadband subscription. Customers using the Internet just to find a job and to e-mail a resume should not have to pay higher rates so other customers can watch the latest blockbuster in HD.

In closing we hope you will take advantage of this unique moment in time to consider how to improve the rules that govern our marketplace that are nearly two decades old and pre-date the emergence of the Internet. Consumers deserve better services than can be provided under today's regulatory regime. We are also concerned about the future of a free and open Internet that is being

threatened by the emerging business model that compels consolidated and dominant content providers to leverage their video content in anti-consumer ways.

Thank you for this opportunity to testify today.