Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Expanding Consumers' Video	)	MB Docket No. 16-42
Navigation Choices	)	
	)	
Commercial Availability of	)	CS Docket No. 97-80
Navigation Devices	)	

COMMENTS OF THE

INTERNATIONAL CENTER FOR LAW & ECONOMICS

APRIL 22, 2016

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Opening Pandora's Set-Top Box

Comments of the International Center for Law & Economics[1]

> **If there is any sector of the economy most fully characterized by dynamic, technological Schumpeterian competition, however, it is [telecommunications]. Technological innovation is, surely, the most powerful and productive kind of competition and underminer of thoroughgoing economic regulation. Wherever and whenever it prevails, it demands deregulation.[2]**

Summary

In this proceeding the Commission proposes to "open" the market for multichannel video programming distributor ("MVPD") set-top box video interfaces. We believe that the Commission's proposed rules fail to take account of the fundamental economic realities that govern the creation of content and its distribution, fail to properly respect copyright and contractual rights, and constitute an inappropriate, to say nothing of unwise, exercise of the Commission's authority under Section 629.

With this NPRM the Commission undertakes an intervention into a market that is robust, competitive, and scarcely in need of regulatory assistance. And Chairman Wheeler is well aware of this reality:

> American consumers enjoy unprecedented choice in how they view entertainment, news and sports programming. You can pretty much watch what you want, where you want, when you want.[3]

Not only is the market robust, but it is rooted in a complicated set of business negotiations (most notably between programmers and distributors) that contain an enormous number of moving parts:

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[1] This document contains an updated version of the original comments we submitted to the FCC on April 22, 2016, primarily to clarify some inadvertently confusing language, update formatting, correct typos, and fix inaccurate or missing citations.

[2] Alfred E. Kahn, *Telecommunications: The Transition from Regulation to Antitrust*, 5 J. TELECOMM. & HIGH TECH. L. 159, 165 (2006).

[3] Tom Wheeler, *It's Time to Unlock the Set-Top Box Market*, RE/CODE (Jan. 27, 2016), http://recode.net/2016/01/27/its-time-to-unlock-the-set-top-box-market/.

> Content providers negotiate with MVPDs along many dimensions, including the presentation of content in terms of adjacencies; how a content producer's brand will be treated; how and when content can be commercialized with advertised; limitations on the use of content as part of a content producer's larger set of business model innovations; and the legal and regulatory obligations of the content producers themselves, including "self-regulatory initiatives such as the Better Business Bureau's Children's Advertising Review Unit ("CARU") and Children's Food and Beverage Advertising Initiative ("CFBAI"), and contractual agreements with writers', directors', and/or actors' guilds."[4]

And not only are the contracts themselves extremely complex, but the various players in content and distribution markets are interrelated in complex and subtle ways. The notion that the FCC could focus in isolation even on something as seemingly incidental as set-top boxes without unanticipated and far-reaching ramifications throughout the ecosystem is misguided.[5]

On the one hand, the Commission's proposed rules seem to dramatically underappreciate and insufficiently assess this underlying complexity, thereby misconstruing the likely effects of the regulation and threatening the investment and innovation that have produced this "Golden Age" of television and home video.[6] On the other hand, if it does proceed with such rules anyway, the Commission should, and perhaps must under the APA and relevant judicial decisions like *Michigan v. EPA*,[7] take much greater care to identify and evaluate the broad consequences—that is to say the costs and benefits—of its rules than it appears to have so far done in this NPRM.

First, the rules ignore an important technological reality.

Existing, and varying, MVPD and online video distributor ("OVD") companies have collectively (and at enormous expense) generated a video ecosystem rich in consumer

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[4] Content Companies, *Letter to Marlene Dortch Re: MB Docket No.15-64* (Jan. 14, 2016), *available at* http://apps.fcc.gov/ecfs/document/view?id=60001404687.

[5] Of course, the issue is not *just* about set-top boxes. The Commission's actions here would strike at the core of the MVPD business model by mandating access to the three video-related streams of discovery information, entitlement information, and video programming. The implications for the video market are far more extensive than a claim that this is merely about set-top boxes would suggest. Unfortunately, the consequence of such an extended assault on the MVPD business model is that the proposed rules far exceed the Commission's mandate granted by Sec. 629, as we discuss *infra.*

[6] *See, e.g.*, David Carr, *Barely Keeping Up in TV's New Golden Age*, THE NEW YORK TIMES (Mar. 9, 2014), http://www.nytimes.com/2014/03/10/business/media/fenced-in-by-televisions-excess-of-excellence.html; Marcus Wohlsen, *When TV Is Obsolete, TV Shows Will Enter Their Real Golden Era*, WIRED (May 15, 2014), http://www.wired.com/2014/05/real-golden-age-television/.

[7] Michigan v. Envtl. Prot. Agency, 14-46, sl. op., 576 U.S. ___ (2015).

choice that shows no signs of under-serving the video-consuming populace.[8] In response to technological advances and evolving consumer preferences, MVPD providers have already been progressively moving their systems into an app-based infrastructure, a move that would, in the very near term, essentially negate the necessity of set-top boxes altogether.[9] What's more, this move has been underway for some time, as competitive pressures have forced MVPDs to serve customers' demands for more-flexible viewing options.[10]

Moreover, this market-driven technological evolution undermines the rationale of the Commission's embrace of Section 629's myopic focus on MVPD set-top boxes by further blurring the lines between MVPD and OVD services. As is so often the case, technological change introduces competition that threatens to make aging statutes irrelevant.[11] In this case, because the statute contains a rare sunset provision for precisely this reason, the statute should simply sunset under its own terms.

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[8] Leaving aside OVD and services like Sling TV, as of 2013, 99% of homes had access to at least three MVPD providers and 100% of homes had access to at least two providers. Sixteenth Report, *In the Matter of the Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, FCC 15-41, at ¶ 31, table 2 (Mar. 31, 2015), *available at* https://apps.fcc.gov/edocs_public/attachmatch/FCC-15-41A1_Rcd.pdf [hereinafter "FCC 16th Video Competition Report"]. And, of course, "[OVD] services, today [are] vibrant and growing … [and] … is occurring naturally in the marketplace, with little or no government involvement." Gerard J. Waldron, *Letter to Marlene Dortch, Re: Notice of Ex Parte Presentation in MB Docket Nos. 15-64 and 14-261*, at 1, *available at* http://apps.fcc.gov/ecfs/document/view?id=60001323504.

[9] Comcast, for example, has created the Xfinity TV Partner Program to enable nearly *any* consumer electronics device to offer set-top-box-free access to Xfinity programming and services. It has already announced integrations with Roku devices and Samsung TVs. *See Comcast and Roku Bring Xfinity TV Partner App to Roku TVs and Roku Streaming Players*, BUSINESSWIRE (Apr. 20, 2016), http://www.businesswire.com/news/home/20160420006318/en/Comcast-Roku-Bring-Xfinity-TV-Partner-App. This program alone, but especially in conjunction with other, ongoing offerings, essentially negates a legitimate public interest basis for this NPRM.

[10] Comcast's X1 platform was originally released in 2012. See Richard Lawler, *Comcast officially launches next-gen X1 DVR platform and iPhone remote app*, ENGADGET (May 21, 2012*), available at* http://www.engadget.com/2012/05/21/comcast-x1-dvr-iphone-app-launch/. The platform has since evolved to include a full suite of app-based options for watching MVPD content. *See Make the most of your services with XFINITY apps*, XFINITY, *available at* http://xfinitytv.comcast.net/apps?cid=customer (last visited Apr. 23, 2016). Time Warner Cable released an app in early 2013 that enabled "Roku streaming boxes [to be] used as cable boxes for Time Warner Cable subscribers." John Falcone, *TWC TV app turns Roku into a cable box for Time Warner customers (hands-on)*, ENGADGET (March 5, 2013), *available at* http://www.cnet.com/news/twc-tv-app-turns-roku-into-a-cable-box-for-time-warner-customers-hands-on/.

[11] The Commission has itself noted this tendency regarding the subjects of its regulations, although generally in the service of *expanding*, not contracting the scope of its claimed authority. Thus in the 2015 Open Internet Order, for example, "The Commission concluded that [ambiguous statutory language] should not be defined in a static way and recognized that the network is continuously growing and changing because of new technology and increasing demand." Report and Order on Remand, *In the Matter of*

Second, the Commission significantly misstates the significance of the set-top box market.

In justifying its intervention, the Commission relies in large part upon an informal survey from Senators Markey and Blumenthal that claims that

> MVPDs take in approximately $19.5 billion per year in set- top box lease fees, so MVPDs have a strong financial incentive to use an approval process to prevent development of a competitive commercial market and continue to require almost all of their subscribers to lease set-top boxes.[12]

Throughout the NRPM the Commission refers to the fees related to set-top boxes as a major consideration for the rules.[13] But this singular focus on the price of these devices in isolation (assuming the senators' revenue claims are actually accurate)[14] is misguided. Regardless of who provides the set-top boxes, they are merely a complement to the underlying MVPD service, which is already highly competitive. MVPD providers are not in a position to extract economic rents from set-top boxes, even if they wanted to.[15] Moreover, for reasons discussed below, the proposed approach in the Commission's NPRM is more likely to *increase* MVPD subscription rates overall, and effect a counterproductive redistribution of costs from some consumers (who currently pay for device rentals) to others (who currently do not).

Although the Commission asserts that set-top boxes are too expensive, the history of overall MVPD prices tells a remarkably different story. Since 1994, per-channel cable prices *including set-top box fees* have fallen by 2 percent, while overall consumer prices have

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Protecting and Promoting the Open Internet, GN Docket No. 14-28, at ¶ 396 (Feb. 26, 2015), *available at* https://apps.fcc.gov/edocs_public/attachmatch/FCC-15-24A1_Rcd.pdf.

[12] Notice of Proposed Rulemaking, *In the Matter of Expanding Consumers' Video Navigation Choices & Commercial Availability of Navigation Devices*, FCC 16-18, at ¶ 28 (Feb. 18, 2016*), available at* https://apps.fcc.gov/edocs_public/attachmatch/FCC-16-18A1.pdf [hereinafter "NPRM"].

[13] *Id.* at ¶¶ 13, 28

[14] Which is strongly disputed. *See* George S. Ford, *The Obama administration is misleading consumers on set-top box prices*, THE HILL (Apr. 21, 2016), http://thehill.com/blogs/pundits-blog/technology/276969-the-obama-administration-is-misleading-consumers-on-set-top-box.

[15] "[O]ur theoretical analysis reveals that the set-top box conveys no market power to the MVPD and that the MVPD has no anticompetitive preference for self-supply. The MVPD simply prefers whatever market arrangements most efficiently deliver the equipment to its consumers. Our analysis reveals that if the equipment can be made cheaper and offered at a lower price, then the MVPD will embrace the cost reduction. Also, if the set-top devices can be made more innovative to increase the value to consumers, then the MVPD is incented to implement that innovation." George S. Ford, et. al, *Wobbling Back to the Fire: Economic Efficiency and the Creation of a Retail Market for Set-Top Boxes* 26 (Phoenix Center Policy Paper Series No 41, Dec. 2010), *available at* http://www.phoenix-center.org/pcpp/PCPP41Final.pdf.

increased by 54 percent.[16] After adjusting for inflation, this represents a substantial overall price decrease. Moreover, over the same period the video marketplace has exploded with distribution choices, the amount and quality of content has dramatically increased, video quality has improved enormously, and MVPD providers have continued to produce increasingly innovative products and services to meet consumer demand.[17]

Third, the Commission is strategically inconsistent in how it treats technological changes in its justification for proposed rules.

The Commission inconsistently, but purposefully, picks and chooses how and when technological evolution will matter for this NPRM. That is, on the one hand, the NPRM hews to the narrow "*market for the multichannel video programming distributors*" language of Sec. 629 in asserting that meaningful competition for devices in the relevant market doesn't currently exist. At the same time, however, it employs a broad technological expansion of Sec. 629's *"converter boxes… and other equipment"* language by applying its mandate not only to physical boxes and equipment, but also to the software-based and *a la carte* user interfaces employed in the broader video market (which includes OVD)—the same market that it *excludes* from its definition of the relevant market in which it must find an absence of competition.

Fourth, the Commission fails to properly assess the extent of competition in the market.

According to the Commission, the first of the three "fundamental points" on which the NPRM rests is that "the market for navigation devices is not competitive."[18] But the Commission's assessment of competition in that market is fatally flawed.

The NPRM points out, for example, that

> [A]lmost all consumers have one source for access to the multichannel video programming to which they subscribe: the leased set-top box, or the MVPD-

[16] Report on Cable Industry Prices, *In the Matter of Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992 & Statistical Report on Average Rates for Basic Service, Cable Programming Service, and Equipment*, MM Docket No 92-266, at ¶ 17, Table 3 (Dec. 15, 2014), *available at* https://apps.fcc.gov/edocs_public/attachmatch/DA-14-1829A1.pdf#page=10.

[17] And even a like-kind comparison of set-top boxes alone reveals a similar quality-adjusted decrease in price/increase in quality. Neil M. Goldberg, NCTA, *Letter to Marlene Dortch, Re: MB Docket Nos. 15-64* (Feb. 11, 2016), *available at* http://apps.fcc.gov/ecfs/document/view?id=60001426631.

[18] NPRM at ¶ 12.

> provided application. Therefore, we tentatively conclude that the market for navigation devices is not competitive….[19]

This statement reflects an inaccurate and simplistic conception of what competition is.

To begin with, while the system may be imperfect, CableCARD still *exists*. That means that every MVPD consumer actually has several additional options (e.g., from TiVo) for accessing their MVPD service. Meanwhile, the "leased set-top box" and the "MVPD-provided application" constitute two sources for access to MVPD content, and are not properly understood as a single service. That both may be provided by the MVPD itself is irrelevant. The very fact that MVPDs have developed alternatives to traditional set-top boxes is an indication that there is competitive pressure driving the MVPDs in the right direction. Moreover, access through set-top boxes and applications differs in numerous, obvious ways, thus providing meaningful consumer choice. If the aim of the NPRM is truly to "Expand[] Consumers' Video Navigation Choices," then by providing both set-top boxes as well as app-based alternatives for accessing MVPD content (at no additional cost, to boot), MVPDs are doing just that.

But more importantly, even if consumers have limited alternative sources for MVPD access, it is a *non sequitur* to say that the market for navigation devices is not competitive as a result. It is neither required by the statute, *nor is it correct as a matter of economics*, to view the aftermarket for set-top boxes in isolation from the broader MVPD market in assessing its competitiveness. If competitive constraints on the set-top box market come from elsewhere, that does not mean—and the statute does not require—that those constraints should be ignored, just because they don't arise from head-to-head competition with other MVPD set-top box manufacturers.

The set-top box market is a derivative, secondary market; no one buys set-top boxes without first buying MVPD service. *Direct* competition for set-top boxes in the aftermarket need not be plentiful for the market to nevertheless be competitive. Rather, the competitiveness of the MVPD market in which the antecedent choice of provider is made incorporates consumers' preferences regarding set-top boxes, and makes the secondary market competitive.[20]

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[19] *Id.* at ¶ 13.

[20] *See, e.g.*, Benjamin Klein, *Market Power in Aftermarkets*, 17 MANAGERIAL & DECISION ECON. 143, 147 (1996) (even "when customers are totally uninformed about aftermarket conditions, a hold-up is not possible as long as competition exists among informed sellers in the primary market… even in this extreme case where consumers are totally ignorant about aftermarkets, consumers will pay a competitive package price"). *See also* NCTA Letter to Marlene Dortch, *Ex Parte Submission of Economic Analysis of the Regulation of MVPD Navigation Devices in Video Device Competition Notice of Inquiry (MB Docket No. 10-91, CS Docket No. 97-80, PP Docket No. 00-67)*, at 8 (Jul. 19, 2010), *available at* http://apps.fcc.gov/ecfs/document/view?id=7020549667 ("Furthermore, because of the complemen-

And that market—the consumer video market, including MVPDs—is plainly competitive. In 2015 the Commission "adopt[ed] a rebuttable presumption that cable operators are subject to 'Effective Competition.'"[21] And, as the FCC's 16th Video Competition Report shows, virtually 100% of consumers have access to three or more MVPDs, and, in 2013, more than 35% had access to at least four MVPDs.[22] That number can only have grown since 2013.

In the same vein, the NPRM notes that

> Certain MVPD commenters argue that the market for devices is competitive… [and] that the popularity of… devices that can access over-the-top services… shows that Congress's goals in Section 629 have been met. We disagree. With certain limited exceptions, it appears that those devices are not "used by consumers to access multichannel video programming," and are even more rarely used as the sole means of accessing MVPDs' programming.[23]

We discuss below why the statutory interpretation here is incorrect. But more fundamentally, the competition need not look identical for it to be a competitive constraint nonetheless. In fact, the Commission itself has acknowledged precisely this point:

> We recognize that the business models and competitive strategies of entities in one group may impact the business models and competitive strategies of entities in the other groups.[24]

In a recent speech FCC General Counsel Jonathan Sallet explained that Commission staff recommended rejecting the Comcast/Time-Warner Cable merger precisely because

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tary relationship between set-top equipment and content services, MVPDs have an incentive to ensure that customer equipment is supplied in the most efficient manner possible in order to sell their content…. This is an example of the common observation about complementary goods that consumers need to have both goods in order to consume the product, so each provider wants the complementary good to be as cheap as possible.").

[21] Report and Order, *In the Matter of Amendment to the Commission's Rules Concerning Effective Competition*, MB Docket No. 15-53, at ¶ 1 (Jun. 2, 2015), *available at* https://apps.fcc.gov/edocs_public/attachmatch/FCC-15-62A1.pdf. "Competing Provider Effective Competition [means] that the franchise area is (i) served by at least two unaffiliated MVPDs each of which offers comparable video programming to at least 50 percent of the households in the franchise area; and (ii) the number of households subscribing to programming services offered by MVPDs other than the largest MVPD exceeds 15 percent of the households in the franchise area." *Id.* at ¶ 2.

[22] FCC 16th Video Competition Report at ¶ 31.

[23] NPRM at ¶ 14.

[24] Public Notice: Media Bureau Seeks Comment on the Status of Competition in the Market for the Delivery of Video Programming, MB Docket No. 15-158, at 3 (July 2, 2015), *available at* https://apps.fcc.gov/edocs_public/attachmatch/DA-15-784A1.pdf.

of the alleged threat it posed to OVD competitors. In essence, Sallet argued that Comcast sought to undertake a $45 billion merger primarily—if not *solely*—in order to ameliorate the competitive threat to its subscription video services from OVDs:

> Simply put, the core concern came down to whether the merged firm would have an increased incentive and ability to safeguard its integrated Pay TV business model and video revenues by limiting the ability of OVDs to compete effectively, especially through the use of new business models.[25]

Thus, not only does the FCC itself appear to believe that this competitive threat is real, but it believes that Comcast, once the largest MVPD in the country, believes *strongly* that the OVD competitive threat is real.

And particularly in markets characterized by the sorts of technological change present in video markets, potential competition can operate as effectively as—or even *more* effectively than—actual competition to generate competitive market conditions:

> [I[n industries such as telecommunications, where technological change is rapid, competition for the market may provide more benefits to consumers than competition in the market. Where competition for the market is important, the number of competitors in the market at any point does not usefully measure the extent to which competitive processes underlie market behaviour.[26]

The Commission has recognized that OVDs are potential competitors in the MVPD (or consumer video) market:

> In the Comcast-NBCU Order, the Commission concluded that, regardless of whether online video currently is a complement to or a substitute for MVPD service, it is potentially a substitute product.[27]

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[25] Remarks of Jon Sallet, Federal Communications Commission General Counsel As Prepared for Delivery Telecommunications Policy Research Conference: "The Federal Communications Commission and Lessons of Recent Mergers & Acquisitions Reviews" September 25, 2015, at 11, *available at* http://transition.fcc.gov/Daily_Releases/Daily_Business/2015/db0925/DOC-335494A1.pdf.

[26] Neil Quigley, *Dynamic Competition in Telecommunications: Implications for Regulatory Policy* 17, C.D. HOWE INSTITUTE COMMENTARY, no. 194 Feb. 2004, *available at* https://www.cdhowe.org/pdf/commentary_194.pdf. *See also* A.E. Kahn, *Telecommunications: The Transition from Regulation to Antitrust*, 5 J. ON TELECOMM. & HIGH TECH. L. 159 (2006); Jason Pearcey & Scott J. Savage, *Actual and Potential Competition in International Telecommunications* 4 (Working Paper, Oct. 21, 2015), *available at* https://www.montana.edu/jpearcy/papers/ISR_Web.pdf ("Overall, these results suggest that incumbent firms reduce their price when potential competition increases…."); Harold Demsetz, *Industry Structure, Market Rivalry and Public Policy*, 16 J. L. & ECON. 1 (1973).

[27] FCC 16th Video Competition Report at ¶ 215.

The FCC first acknowledged the importance of OVDs as potential competitors to MVPDs in its 2012 14th Video Competition Report, and the extent of competition between the two has increased dramatically since then.[28]

Fifth, the proposed rules ignore the complexity of these markets.

The current rulemaking represents an overt assault on the web of contracts that makes content generation and distribution possible. MVPD (and OVD, for that matter) content originates as the result of a highly complicated set of contractual negotiations, and is intertwined with a variety of legal rights, particularly intellectual property rights, that are not easily amenable to the Commission's contemplated course in the NPRM.[29]

The rules would create a new class of intermediaries lacking contractual privity with content providers (or MVPDs), and would therefore force MVPDs to bear the unpredictable consequences of providing licensed content to third-parties without actual contracts to govern those licenses.

Sixth, the rules would create a deep conflict in the law affecting MVPDs, content creation, and content distribution.

The Communications Act and Copyright Act must operate in unison in order to provide a stable legal and business environment for creators and distributors.[30] The proposed rules could create a situation in which MVPD-provided content is used to lure viewers into the consumption of infringing content by disintermediating MVPDs from their customers, thereby frustrating MVPD compliance burdens under their copyright and distribution licenses and under laws aimed at protecting intellectual property. Further, to the extent that MVPDs negotiate various terms with content providers—including, e.g., channel placement, advertising, and the like—redistributing content to third-parties who lack contractual relationships with either content providers or MVPDs makes it impossible to enforce the terms under which content is made available for distribution in the first place.

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[28] For example, "since 2010, the percent of TV viewers who stream at least some of their TV content has risen from 15% at the beginning of 2010 to 57% in January 2016…. Notably, 75% of Core Streamers who have a multichannel subscription report being interested in replacing it with an Internet-delivered, linear, skinny bundle of only their 'essential' networks, at the right price, which translates to 22% of total TV viewers." *Opportunity for Over-the-Top Providers in New Video Ecosystem; Broadcast Content Is Key*, HOROWITZ RESEARCH (April 19, 2016), *available at* http://www.horowitzresearch.com/news/press-releases/opportunity-for-over-the-top-providers-in-new-video-ecosystem-broadcast-content-is-key/.

[29] *See* Neil Fried, *The FCC Should Say "No" to AllVid: Part Two*, MPAA (Feb. 3, 2016), http://www.mpaa.org/allvid.

[30] *See, e.g.*, United States v. Stewart, 311 U.S. 60, 64 (1940) (statutes relating to the same subject matter should be construed together).

In these ways the rules essentially mandate that MVPDs both potentially facilitate widespread copyright infringement as well as violate a number of contractual obligations owed to content providers.

Further, in addition to the NPRM distorting content markets by allowing third-parties to "acquire" video without licensing fees, it would provide a regulatory advantage to those third-parties by allowing them to use consumer data under a much more lenient set of privacy requirements than those faced by MVPDs.[31]

Seventh, innovation and competition are already happening, and "unbundling" rules like these are unlikely to help.

The NPRM would, ironically, work regressively toward a distribution model in which entrenched MVPD providers and the broadest possible program bundles remain dominant, and in which marginal interface providers receive a regulatory windfall for merely repackaging MVPD content—all in the name of "competition." But the Commission has experience with just this sort of failed effort to promote competition and innovation. In its attempt to "promote facilities-based competition, investment, and innovation"[32] with its *Unbundling of Network Elements* NPRM,[33] the Commission failed to introduce any real competition or innovation at all.[34] As in that case, there is no reason to presume that allowing third-parties to free ride on the efforts of MVPDs will in any way introduce innovation or beneficial competition here.

Moreover, consumers have been consistently "voting with their feet" by defecting from large MVPD packages.[35] Yet the proposed rules would privilege MVPD bundles by re-

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[31] For instance, the NPRM does not propose requiring third-parties to meet the obligations of 47 U.S.C. § 551 or 47 U.S.C. § 338(i), even though MVPDs would remain bound under these same obligations.

[32] Notice of Proposed Rulemaking, *In the Matter of Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers Implementation of the Local Competition Provisions of the Telecommunications Act of 1996 Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Dkt. Nos. 01-338, 96-98, 98-147, at ¶ 9 (2001).

[33] FCC, *FCC Promotes Local Telecommunications Competition* (Sept. 15, 1999), *available at* https://transition.fcc.gov/Bureaus/Common_Carrier/News_Releases/1999/nrcc9066.html.

[34] *See, e.g.*, Thomas M. Jorde, J. Gregory Sidak, & David J. Teece, *Innovation, Investment, and Unbundling*, 17 YALE J. ON REG. 1 (2000), *available at* https://www.criterioneconomics.com/docs/innovation_investment_and_unbundling1.pdf; Christian M. Dippon & Harold Ware, *Wholesale Unbundling and Intermodal Competition*, NERA ECONOMIC CONSULTING (Jan. 7, 2010), *available at* http://www.nera.com/content/dam/nera/publications/archive2/PUB_Wholesale_Competition_0713.pdf.

[35] Jan Dawson, *Cord-Cutting Continues: Don't Believe the Early Q4 Hype*, VARIETY (Feb. 26, 2016), http://variety.com/2016/data/opinion/cord-cutting-continues-dont-believe-the-early-q4-hype-1201716052/; Wayne Friedman, *OTT Service Forecast To See Sharp Growth In Next 5 Years*, MEDIADAILYN-

ducing the transaction costs associated with acquiring full-bundle video programming through third-party user interfaces below the level associated with individual negotiation. Far from making the playing field level, the rules would tilt the entire game, and encourage the progress toward apps and *a la carte* services to reverse and gravitate toward MVPD-based, repackaged content.

In sum, the proposed rules would short-circuit and distort the thriving app marketplace that consumers have increasingly been moving toward.

The approach taken in this NPRM will likely encourage an inertia that favors dominant MVPDs as the preferred source of video content—after all, why would third-parties bother negotiating licenses when the same video content can be had for zero cost and easily repackaged with their own ads?

The disconnect between distribution and viewing would have a destabilizing effect on content production, ultimately leading to less content that is simultaneously more-expensive. The current contractual relationships between MVPDs and content owners allow for a fine-grained tuning of rights and revenues—exactly the sort of "transactional entrepreneurship" that leads to innovation and competition. Instead, the fractured scenario envisioned by the NPRM will induce programmers and rights holders to attempt a scattershot approach to reaching their audiences through direct ad buys, while *also* maintaining their relationships with MVPDs. This would add cost and reduce quality—and will almost certainly reduce the supply of content and drive up prices for consumers.

Competition and consumer welfare: The market landscape

The proposed rules are an anachronism based on a Congressional mandate from 1996—before digital cable was even widely available—when the relevant market for home video consisted essentially of a cable company offering a few channels of low-definition programming and Blockbuster Video. The authors of Section 629 certainly did not anticipate services such as Amazon Prime Video, Netflix, TiVo or Hulu at the time of drafting. Nevertheless, acknowledging the limits of foresight, Section 629 was written with the recognition that video markets were dynamic and very likely to undergo substantial change. In fact, it is one of the very few sections in the Communications Act that explicitly directs the FCC to sunset the regulations it adopts under the provision—

EWS (Nov. 18, 2015), http://www.mediapost.com/publications/article/262924/ott-service-forecast-to-see-sharp-growth-in-next-5.html.

in this case when the market for video distribution and equipment matures through inevitable technological evolution.[36]

The NPRM flies in the face of this competitive reality. Instead, it simply ignores Sec. 629(e) (it is literally nowhere mentioned or cited in the NPRM), and fails to address whether the preconditions that would trigger the sunsetting provision have been met. In large part, presumably, this is a function of the implicit contention that "the market for the multichannel video programming distributors is [not] fully competitive," and/or the explicit contention that "the market for converter boxes, and interactive communications equipment, used in conjunction with that service is [not] fully competitive."[37]

The artificially narrow interpretation of the relevant market employed by the Commission to reach this conclusion is, however, neither a reasonable nor a permissible exercise of the Commission's rulemaking authority.

It's indisputable that the statute directs the FCC to address the MVPD market and the MVPD set-top box market. The competitiveness of a market is not solely a function of the number of competitors in that market, however. Even relatively constrained markets like these can be "fully competitive" with only a few competing firms, as is the case in every market in which MVPDs operate (and which the Commission has deemed presumptively competitive).[38]

At the same time—and more importantly—competition *within* a market can come from *outside* that market. MVPDs face relentless competition from OVD providers (as Chairman Wheeler has acknowledged).[39]

Incorporating consideration of non-MVPD video distribution in the application of Section 629 is, moreover, consistent with (and, in fact, *less* expansive than) the Commis-

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[36] *See* 47 U.S.C. § 629. Note that given the reality of a *different* and *largely unforeseeable* form of competition in the dramatically expanded OVD offerings, it is logically consistent that the sunset provision may in fact apply to today's broader market (that is, not limited solely to MVPDs). After all, what is the purpose of ensuring set-top box choice if not to incentivize the very sorts of innovations like OVD apps that have emerged to compete with MVPDs? Thus, as the market has discovered a means of providing the real value – the actual video – the Commission should apply 629(e).

[37] *Cf.* 47 U.S.C. §§ 629(e)(1) & (e)(2).

[38] *See* Report and Order, *In the Matter of Amendment to the Commission's Rules Concerning Effective Competition*, MB Docket No. 15-53, at ¶ 1 (Jun. 2, 2015), *available at* https://apps.fcc.gov/edocs_public/attachmatch/FCC-15-62A1.pdf.

[39] Statement of Chairman Tom Wheeler, Re: Promoting Innovation and Competition in the Provision of Multichannel Video Programming Distribution Services, MB Docket No. 14-261, *available at* https://apps.fcc.gov/edocs_public/attachmatch/FCC-14-210A2.pdf ("When digital technology made video simply zeroes and ones, it opened up the opportunity for new Internet-based competition to cable and satellite services... Video is no longer tied to a certain transmission technology.").

sion's stated views on the video market. Less than two years ago the Commission was of the opinion that the definition of MVPD should be expanded to include "within its scope services that make available for purchase, by subscribers or customers, multiple linear streams of video programming, regardless of the technology used to distribute the programming."[40] Although outcry from the intended "beneficiaries" of the proposed rules seems to have defeated them, such a proposal evidences the Commission's clear understanding that a proper understanding of competition in the contemporary market for video services must include both OVD and MVPD providers. As Chairman Wheeler said in justifying the NPRM's treatment of over-the-top and MVPD distribution as a single video market, "[v]ideo is no longer tied to a certain transmission technology."[41]

Further, even as it ignores OVDs as a source of competitive constraint on MVPDs and MVPD set-top boxes, the NPRM simultaneously creates a sort of "innovation mandate" that Section 629 did not encompass at the time of drafting, and that implicitly embraces MVPD/OVD competition:

> [U]naffiliated vendors must be able to differentiate themselves in order to effectively compete based on the user interface and complementary features they offer users (e.g., integrated search across MVPD content and over-the-top content…).[42]

This sort of differentiation makes sense only if over-the-top content distribution services actually compete with MVPDs. The irony is that the NPRM seeks to give a leg up to non-MVPD distribution services in order to promote competition with MVPDs, while simultaneously denying that such competition exists.

This same interpretative sleight of hand also turns Section 629 into an effective mandate to erase the business model of MVPDs. But Section 629 is a narrowly-written provision intended to ensure that retail equipment will be available to allow consumers to access MVPD services *as offered by MVPDs*.

In fact, Congress *explicitly* rejected language that would have required unbundling of MVPDs' content and services in order to promote other distribution services[43] by narrowing it to promote the availability of "only equipment used to access services provid-

[40] Notice of Proposed Rulemaking, *In the Matter of Promoting Innovation and Competition in the Provision of Multichannel Video Programming Distribution Services*, MB Docket 14-261, ¶ 1 (Dec. 17, 2014), *available at* https://apps.fcc.gov/edocs_public/attachmatch/FCC-14-210A1.pdf.

[41] John Eggerton, *FCC's Wheeler: OTT Report And Order By Fall*, BROADCASTING & CABLE (Jun. 26, 2015), http://www.broadcastingcable.com/news/washington/fccs-wheeler-ott-report-and-order-fall/142159.

[42] NPRM at ¶ 27.

[43] H.R. Rep. No. 104-204, at 112 (1995).

ed by multichannel video programming distributors."[44] Where Congress *rejected* language that would have favored non-MVPD services, the Commission selectively interprets the language Congress *did* employ in order to accomplish exactly what Congress rejected.

Further, the proposed rules contemplate expanding access to MVPD content via software-based mechanisms. Here, as well, the Commission both understands the broader competitive market, yet ignores that market when it's convenient to "finding" statutory authority. The statute is textually focused on "boxes" and "equipment," and the Commission correctly understands that such a narrow focus is inconsistent with technological reality that incorporates software-based interfaces. Yet when defining the relevant market in order to assess the extent of competition in it (as it must under the terms of Sec. 629(e)), the Commission concludes that there is not sufficient competition—a result it can reach only by ignoring the wealth of software- and app-based video offerings currently available.

Thus, the NPRM gets it exactly backward. It *rejects* consideration of non-MVPD distribution sources in assessing competitiveness, but then turns around and adopts rules to *promote* those services—in both cases, against congressional intent.

Heads they win, tails MVPDs lose.

In essence, third-parties already have many opportunities to integrate and be integrated—from smart TVs and game systems, to licensing arrangements with MVPD systems and content creators. At best, the proposed rules would present a shortcut to get around the extensive business negotiations required to put together a mature, attractive video offering. What this is not, however, is merely about providing consumer access to content.

When the Commission describes an initial market suffering from a dearth of video access measures around MVPD content, it is, with troubling inconsistency, overconstraining the initial analysis in a way that ultimately benefits the very parties (OVDs) that currently have a strong market but whose market strength doesn't count in the first analysis.

The Commission is setting up a "heads they win, tails MVPDs lose" scenario: The market for accessing video content is broken because MVPDs don't allow competitors to access their streams, but those same competitors who already have flourishing video products don't change the calculus of regulatory justification under Section 629 that finds competition lacking.

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[44] H.R. Conf. Rep. No. 104-458, at 181 (1996).

Interestingly, the legislative history of Section 629 commands the Commission to "take cognizance of the current state of the marketplace" before issuing rules,[45] and full cognizance surely must include the incredible wealth of competitive video viewing options now available (and previously undreamt of, at least when the provision was drafted). Even if competitors are not themselves MVPDs, they are no less competitors, and exert no less competitive constraint on the MVPD market. The Commission's narrow reading of some (but not other) language in Section 629 is in no way required (or justified) by the statute.

Finally, it is impossible to avoid the conclusion that the FCC's unrealistic and narrow definition of the market here is simply an effort to avoid the sun-setting provisions of Section 629, which would otherwise *deny* expansive authority to the Commission. Section 629(e) directs the Commission to consider when the market changes and, upon such a finding, to cease its regulation in the area. Despite its reference to "the market for *multichannel video programming* distributors"[46]—and the FCC's sudden fealty to the narrowest possible reading of statutory terms, despite its willingness to view other terms (like "equipment") quite broadly—viewed as a whole, Section 629 is fairly read as requiring the Commission to consider the fact of broad consumer choice in video consumption, a fact that, if anything, should cause the Commission to consider sunsetting the provision instead of expanding its regulatory activity.

In order to avoid triggering Section 629(e) the Commission is forced to pretend that we still live in the world of Blockbuster rentals and analog cable. It must ignore the Netflix behind the curtain—ignore the utter wealth of video choices available to consumers—and focus on the fact that a consumer might have a remote for an Apple TV sitting next to her Xfinity remote.

And, Section 629(e) presents another problem for the proposed course laid out in the rules. Section 629(e) explicitly calls on the Commission to evaluate the competitiveness of the video market as well as the market for video navigation devices. When Congress explicitly imposes specific evaluative obligations on an agency, as it does in Section 629(e), those agencies are required to weigh the costs and benefits of the proposed regulation. If an agency fails to conduct such an analysis, it gives courts a firm basis for striking the regulation.[47] Yet, despite this obligation, the Commission failed to undertake a thorough analysis that includes proper market definition and a weighing of the costs and benefits of the rules.

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[45] 47 U.S.C. § 629(e).

[46] 47 U.S.C. § 629(e)(1).

[47] *See* Michigan v. Envtl. Prot. Agency, 14-46, sl. op., 576 U.S. ___ (2015).

The underlying statutory aim of Section 629—that consumers have a multitude of methods for accessing video content—has been achieved by the market already, in part through new software-based distribution mechanisms. All signs point toward the market continuing to evolve in that direction, and for more varieties of user interface, content bundles and content to be available to more consumers.[48] And not only has content grown dramatically,[49] but the method by which consumers access that video is increasingly diverse.[50]

Expressed consumer preferences regarding consumption of video services is similarly unsupportive of the proposed rules. Consumer surveys have demonstrated that over the last few years 50% of respondents either "cut" or "shaved" their MVPD service.[51] Fewer and fewer consumers are interested in traditional MVPD services at all, in other words.

It is therefore difficult to believe that "consumers have few alternatives to leasing set-top boxes from their MVPDs."[52] Relying upon this willful misunderstanding of reality as the basis for extensive and destructive regulations is not only misguided, it is completely at odds with the promotion of consumer welfare. The NPRM's narrow focus on one small piece of the market is not merely inconsistent with market realities; it is also ill-serving of the public interest and a total waste of the Commission's limited resources.

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48 SNL KAGAN, U.S. AVAILABILITY OF FILM AND TV TITLES IN THE DIGITAL AGE 13, Chart 10 (shows a 3-4% growth in at least some content, and much more growth in availability generally) (March 2016), *available at* http://go.snl.com/rs/080-PQS-123/images/U.S.%20Availability%20of%20Film%20and%20TV%20Titles%20in%20the%20Digital%20Age.pdf.

49 There has been a 94% increase in the availability of long-form scripted shows *just since 2009*. Lisa de Moraes, *FX Study: Record 409 Scripted Series On TV In 2015*, Deadline (Dec. 16, 2015), http://deadline.com/2015/12/tv-study-record-number-scripted-series-fx-1201668200/.

50 Whereas in 1992, 57% of all programming was through cable systems, it currently stands at about 11%. Sixteenth Video Competition Report; Fifteenth Competition Video Report. Moreover, currently 9.2M households use OVD providers for their video viewing – a number that is expected to climb to 12.9M by 2019. https://www.snl.com/InteractiveX/article.aspx?ID=34481378. It should be noted that these figures do not even account for the currently growing "virtual" MVPDs like Sling TV, which would add an additional 500,000 subscribers to the figure. And according to Comcast, "There are hundreds of millions of ... connected devices in the marketplace – far outpacing the number of traditional MVPD-supplied set-top boxes – and the popularity and use of these devices continue to soar. In fact, over 460 million connected devices support one or more MVPD apps, and 66 percent of them support apps from all of the top 10 MVPDs." Comcast letter to FCC, p 3-4

51 *See* Sarah Perez, *New Study Shows A Rise in Cord-Cutting – 8.2 Percent Ditched Pay TV In 2014, Up 1.3% YoY*, TECHCRUNCH (Jun. 23, 2015), http://techcrunch.com/2015/06/23/new-study-shows-a-rise-in-cord-cutting-8-2-percent-ditched-pay-tv-in-2014-up-1-3-yoy/.

52 NPRM at ¶ 13.

The economics and business of content production and distribution

Not only are the proposed rules unnecessary given the wealth of video platforms and content, they threaten to disrupt large portions of the content and distribution industries by blindly ramming third-parties into a complicated and evolved set of carefully negotiated commercial contracts.

Generally, the video markets at issue are what economists refer to as multi-sided (or two-sided) markets. A multi-sided market is a business model that creates value by reducing the transaction costs of direct interactions between two or more types of customers in innovative ways that mere resellers cannot replicate.[53] Such markets connect a variety of different parties through a single platform, and thereby enable the delivery of different goods and services in an efficient manner.[54]

Video distribution platforms, particularly MVPDs, connect content producers, advertisers, and consumers, enabling each to derive value from the platform while also facilitating the long-term growth of the platform itself. In this network of interests, contractual negotiations between the various parties and the MVPD provider represent control points through which interests are balanced.

The contracts surrounding content distribution aren't only about the availability, pricing and protection of *content*; they are also about promoting the platform. But the two are inextricably intertwined. The proposed rules plainly threaten to disrupt a significant amount of the settled expectations that have formed around the creation of these interdependent contractual control points. This threatens not just the delivery of content from MVPDs to consumers, but will likely undermine the incentive structures that encourage the creation and availability of new, quality content in the first place.

Chairman Wheeler appears to recognize this. In the Fact Sheet accompanying announcement of the NPRM the Chairman stressed the need for maintaining the environment that makes the wealth of content creation possible: "Existing content distribution deals, licensing terms, and conditions will remain unchanged."[55] But nothing in the NPRM protects those licenses or suggests that the Commission has undertaken to as-

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[53] *See generally* David S. Evans & Richard Schmalensee, *The Antitrust Analysis of Multi-Sided Platform Businesses*, *in* OXFORD HANDBOOK ON INTERNATIONAL ANTITRUST ECONOMICS (Roger Blair and Daniel Sokol, eds., 2013).

[54] *See* David S. Evans, *Two-Sided Market Definition* 4, *in* MARKET DEFINITION IN ANTITRUST: THEORY AND CASE STUDIES (2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1396751.

[55] FCC Chairman Proposal to Unlock the Set-Top Box: Creating Choice & Innovation (Jan. 27, 2016), *available at* https://apps.fcc.gov/edocs_public/attachmatch/DOC-337449A1.pdf.

sess the implications for content creation and pricing of the proposed rules. To the contrary, the NPRM seems to willfully ignore the fact that the government is effectively exempting a preferred class of beneficiaries—the third-party device makers driving this proposal—from their otherwise-applicable legal obligation to obtain a contractual license to commercially exploit content for their own benefit.

Among other things, for example, the NPRM implicates (and fails adequately to address) interference with contractual restrictions on the locations where content could be viewed and what devices would be allowed to display content.[56] It is impossible to mandate "open access" to MVPD video and data streams without disrupting these contract terms—which in turn implicate price terms and, ultimately, content availability.

Similarly, content producers and aggregators negotiate for channel assignment and neighborhood placement, basing price terms and longer-term investment decisions on their relative positions. And IP rights holders negotiate with distributors at various levels for windowing and other restrictions as part of a general distribution plan. Programmers also impose a variety of restrictions on distributors concerning out-of-home access, including whether content is viewable only in a particular home, or, when it is accessible elsewhere, how many copies may be downloaded and how long the right to view them persists. Video on demand ("VOD") rights are heavily negotiated and tied, in often-complicated ways, to windowing and out-of-home viewing restrictions. And, of course, advertising is a crucial source of revenue for both content owners, programmers and MVPDs, and allocation of rights and responsibilities around advertising are also carefully negotiated and implemented by contract.

The DSTAC report was detailed on this point:

> [A]greements between service providers and content providers enforce availability windows, define channel placement and the neighborhood in which the channel is located, subscription tier placement, acceptable advertising, scope of distribution permitted, and security requirements. Content providers may negotiate terms to assure a uniform nationwide presentation and provide consumers with a consistent experience with their branded content. Content may be licensed to a distributor for in home distribution, but only a subset is licensed for out of home use … One provider noted how its Mosaic service included licensed thumbnails, but use of the thumbnails came with license restrictions and application requirements … Some satellite licenses require geolocation of the subscriber account, or remote, IP-connected consumer device. Other satellite licenses forbid outputs to televisions that lack the HDCP protection required to enforce license restrictions on copy control and redistribution … Licenses for VOD may require a network branded point of entry for the VOD

[56] *See* NPRM at ¶ 26

> library, rather than simply commingling that network's licensed content with other VOD.[57]

At the same time, retransmission consent agreements are predicated on expectations regarding market size, subscriber uptake rates, advertising revenues, and the like. MVPDs are also frequently bound by a variety of branding and other placement constraints—for instance, grouping channels of a common brand together and avoiding placing a programmer of children's content alongside one of adult content.

All of these considerations emerge on an individual basis between MVPDs and content owners, and reflect a balance that informs their contracts and ultimately the basic investment decisions of content creators:

> The ultimate challenge of financing is that someone is asked to judge this creative value proposition at a root stage without adequate inputs to make the decision required. This is a nearly impossible task. Additionally, it helps explain why the development process is so murky, protracted, subject to second-guessing, and littered with projects that "almost got made."… As the business continues to grow riskier and more complex… studios have sought a variety of methods to secure production financing, acknowledging that they need to cede some upside [typically by agreeing to a deal that is part cash and part ad-revenue based] to offset the enormous risks taken.[58]

"Existing content distribution deals, licensing terms, and conditions" simply *cannot* "remain unchanged" when the predicates for these agreements are so thoroughly disrupted by regulations such as the proposed rules. Moreover, the contemplated disruption would cause inherent uncertainty. Under the proposed rules new services without any contractual relationship with content providers or MVPDs can begin service at any time. And in any given market that service could have wildly varying effects on programmer/MVPD contracts depending, for instance, on whether the new service is being offered by a small upstart, or, say, Facebook.

One apparent aim of the rules is to make available on any device and at any time the content to which a subscriber has access through her MVPD subscription. Such "freedom" to consume beyond the limitations set forth in carriage agreements between content providers and MVPDs, however, will not in fact be free. As noted above, content providers develop pricing for their content based around the full scope of what they can expect to earn from various sources; changing the dependability of licensing restrictions, such as windowing, advertising placement, and device restrictions alters those expecta-

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[57] Report of Working Group 2 to DSTAC 6-7 (Apr. 21, 2015), *available at* https://transition.fcc.gov/dstac/dstac-report-final-08282015.pdf#page=33.

[58] JEFFREY C. ULIN, THE BUSINESS OF MEDIA DISTRIBUTION 81-83 (2010).

tions. And a very broad approach to the current NPRM by the Commission—one that would open access to MVPD video streams on-demand by third-party app providers—could do just this. The NPRM effectively forecloses compensation from devices and edge-based "apps" that would otherwise negotiate licenses and compensation to content providers. As a consequence, content providers will have an incentive to aggregate their revenue sources into fewer and more easily controlled points in their negotiations. Carriage and licensing fees to MVPD providers (and OVD providers) would increase as content providers seek to "smooth out" the unforeseeable inconsistencies that widely available and uncontrolled MVPD access could cause.[59]

Thus, either the end point of these rules is to completely price the MVPD model out of the market—a strange goal to pursue under an Act that is designed to *enhance* competition, not destroy competing industries—or else it will result in *higher* prices to consumers as MVPDs and content providers rebalance their respective rights and obligations.

For instance, Sling TV recently announced[60] a deal with Fox that will offer a different multi-stream version of its product—notably one that does not include Disney properties because Disney has declined to offer its service to Sling TV on a multi-stream basis. All three companies came to a mutually agreeable business decision in this case. The proposed rules, however, will completely destroy these negotiated positions by mandating that all MVPD content be available on all devices and through all apps that wish to bundle them: "Consumers must be able to receive and use all of content that they pay for no matter the device or application they choose, so long as that device or application protects content sufficiently."[61] While that may seem like a "win" for consumers, only a superficial and misguided analysis would so conclude. Instead, the business realities that compelled those negotiations will not disappear with the wave of the Commission's pen. Disney and Fox will still seek to realize the revenue they expected in some fashion, and, for Disney in particular, mandatory multi-stream availability of its programming will require more compensation. The likely result will be higher carriage fees charged to MVPDs (and others) because they will not be able to finely tune their distribution arrangements—and this of course means that prices to consumers will rise as those costs are passed on.

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[59] After all, an inability of content providers to properly account for all distribution possibilities—including unlicensed use of content by third-parties—in their contracts amounts to a shifting of costs from MVPDs and third-parties onto the content providers themselves.

[60] *See* Shalini Ramachandran, *Sling TV Launches New Multi-Stream Version With Fox Channels*, WALL ST. J. (Apr. 13, 2016), http://www.wsj.com/article_email/sling-tv-launches-new-multi-stream-version-with-fox-channels-1460550786-lMyQjAxMTI2MzE5MzAxNjM5Wj?mg=id-wsj.

[61] NPRM at ¶ 39.

The important role of advertising as a foundation for content production and distribution.

Advertising negotiations are similarly complex, similarly crucial to content production and distribution, and will be similarly upended by the proposed rules.

Advertising drives much of the profitability of both content creation and video distribution.[62] By empowering third-parties to strip out embedded advertising in favor of their own, or to otherwise interfere with the delivery of advertising, the proposed rules undermine critical support for the distribution and creation of video programming. Decisions regarding content development by programmers, live content licensing by cable and broadcast channels, program access rates, broadcasters' retransmission consent vs. must-carry decisions, cable and satellite subscription rates, carriage decisions, exclusivity deals, and MVPDs' own content development plans are all dependent on expectations regarding advertising revenue. The ability of third-parties to defeat or complicate those expectations will inject enormous uncertainty into existing arrangements and long-term plans. Yet the NPRM does not really address the effects of its rules on advertising and advertising deals.

Although the Commission appears noncommittal with respect to third-parties removing ads, short of requiring contractual obligations between MVPDs and content producers to pass through to third-party set-top box providers, it appears highly unlikely that either technical or regulatory barriers exist that would prevent the removal of advertising from provided streams, the overlaying of alternate advertising on top of streams, or the wrapping of video display windows in alternate advertising.[63] In the face of such uncertainty regarding whether or not advertising will actually reach its intended target, in its intended place and at its intended time, the relative value of that advertising will decline. This will result in an increase in the cost of MVPD services to consumers—as well as an increase in the relative attractiveness to content producers of OVD providers as direct licensees. However, as recent history has begun to bear out, consumers tend to pay at least as much, if not more, for bundles of OVD services than they currently do for their large-bundle MVPD packages.[64] Injecting uncertainty into advertising revenue streams will likely increase overall prices for consumers.

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[62] *See, e.g.*, Gregory S. Crawford, *The Economics of Television and Online Video Markets*, *in* HANDBOOK OF MEDIA ECONOMICS (Anderson, Waldfogel, and Stromberg, eds., 2015).

[63] *See* NPRM at ¶ 80 n.232.

[64] *See, e.g.*, Tony Dreier, *OTT Channel Bundles Coming in 2015, But Don't Count on Savings*, STREAMING MEDIA, Jan./Feb. 2015, ***available at*** http://www.streamingmedia.com/Articles/Editorial/Featured-Articles/OTT-Channel-Bundles-Coming-in-2015-But-Dont-Count-on-Savings-101311.aspx.

The DSTAC report specifically and extensively addresses the ability of its various proposals to preserve advertising in content streams and to prevent third-party devices from wrapping or overlaying content with a third-party's own advertising, with some members noting in particular that the virtual headend proposal fails to account for the possibility of improper ad overlays. Nevertheless, the NPRM is silent on the issue.[65] Even if third-parties do not strip out advertising,[66] the effect of overlaying their own advertising could be destructive to the revenue of MVPDs and content providers. Ads overlaid by third-parties would directly compete with programmer-provided ads, diluting the value of television ads and eventually siphoning off enough viewers that the efficacy of the ads will decline, and MVPDs will be forced to shift their costs onto consumers in the form of increased fees.

At worst, and far more likely, the rules will generate a tremendous amount of uncertainty around content consumption, which will devalue advertising properties and increase capital costs for the content industry. The long run consequences of undermining the ad revenue that MVPDs and content providers depend on would be, as noted above, to shift content deals such that OVDs become preferred partners, thus negating the entire purpose of this NPRM.

The likely effects of upending advertising revenue expectations are three-fold:

First, content producers will seek out more opportunities for product placements inside of video programs in order to more effectively guarantee their revenues. Even though

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[65] "The Device Proposal offers no restriction against prohibited ad overlays, whether agreed upon with content providers or required when airing children's programming." DSTAC Report at p. 153. In fact, the Commission is "[p]roposing to leave licensing terms such as… treatment of advertising to marketplace forces," despite first requiring what amounts to a compulsory license that demands the surrender of content. NPRM at ¶ 2. It is not clear exactly how MVPDs would be able to negotiate regarding advertising overlays in this context. The Commission further states that "[w]e do not currently have evidence that regulations are needed to address concerns raised by MVPDs and content providers that competitive navigation solutions will … replace or alter advertising, or improperly manipulate content." *Id.* at ¶ 80. Yet, to some extent, such alteration is the very essence of the proposed approach.

[66] It should be noted that, somewhat separately from these advertising display issues, the NPRM hedges on the question of whether advertising information will be included in the three required streams: "we tentatively conclude that Service Discovery Data need not include descriptive information about the advertising embedded within the program, to ensure that competitive Navigation Devices do not use that data to replace or alter advertising." NPRM at ¶ 80 n.232. On this point, we would strongly urge the Commission to definitively *exclude* advertising data from the data stream, as user-interface providers *should* have no necessary use for information regarding the advertising that accompanies content.

this appears to be happening to some extent already, the rules will artificially exacerbate this trend.[67]

Second, more advertising will move to the third-party provider platforms, meaning more private user data will be pushed into the relatively less-regulated world of digital ad networks.

Third, and perhaps most dramatic, some channels will simply disappear.[68] Particularly for diversity programming and channels that service niche audiences, the ability to reach minimum viable scale will diminish with the reduction in ad revenue. The net effect will be will be toward still-large, but relatively smaller bundles that don't include marginal channels. The NPRM notes that

> Some argue that these business-to-business deals are essential to ensure that the few independent, diverse programmers that currently exist can continue to survive because they ensure that those programmers can rely on the channel placement and advertising agreements that they have contracted for with the MVPD.[69]

But it goes on to dismiss these concerns, claiming that

> Our expectation, however, is that competition in interfaces, menus, search functions, and improved over-the-top integration will make it easier for consumers to find and watch minority and special interest programming. In addition, our goal is to preserve the contractual arrangements between programmers and MVPDs, while creating additional opportunities for programmers, who may not have an arrangement with an MVPD, to reach consumers.[70]

It should be noted, however, that to the extent minority channels continue to exist, they will lose much of the advantage they obtain from favorable "neighborhood" placement

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[67] Which is starting to happen more. *See, e.g.*, Sydney Ember, *TV Networks Recast the Role of Commercials*, THE NEW YORK TIMES (Feb. 26, 2016), http://www.nytimes.com/2016/02/27/business/media/tv-networks-recast-the-role-of-commercials.html.

[68] *See HTTP and Hispanic Coalition Response to AllVid Proposal*, HTTP (Feb. 4, 2016), *available at* http://httponline.org/2016/02/http-and-hispanic-coalition-response-to-allvid-proposal-february-4-2016/ ("Diverse programmers today depend upon carefully negotiated licensing agreements to set the terms by which their shows will be distributed, covering issues like advertising, channel placement, and on-demand replays. But AllVid would let tech companies raid these agreements, ignore their terms or pile on layers of new advertisements of their own. That would further devalue diverse programming and make it harder for networks serving communities of color to find an audience and survive. In the worst case, it would lead to a new round of TV "redlining" in which AllVid companies pick and choose what networks to show and drop Latino programming or bury it deep in the channel lineup or search results.").

[69] NPRM at ¶ 17.

[70] *Id.*

on MVPD lineups. The well-known "filter bubble" effect of online search will migrate to video search, resulting in reinforcement of existing viewing preferences, and further marginalization of minority programming.[71] Resorting to better search algorithms is unlikely to help, either, because by definition a search algorithm nullifies the agreed upon positioning and marketing arrangements on which distribution of the channel was licensed in the first place. Standard search, no matter how powerful, is not very effective at providing long-tail results.[72]

Here, the Commission should pause, particularly in light of its commitment to principles of net neutrality. Pushing the value associated with video distribution into third-parties essentially creates a new class of intermediaries with the power to control what is seen, when it is seen, and by whom it is seen. In a perfectly free market it is unobjectionable that any market player could acquire market power based on satisfying consumer preferences. But the proposed rules would upend a functioning market and artificially privilege large third-parties with the ability to mine video streams and provide their own complementary content and advertising. The rules, far from creating a level playing field, systematically favor these third-parties to the detriment of MVPDs and content providers, and, more importantly, consumers.

An unwieldy rule with dramatic consequences.

Chairman Wheeler has described the MVPD *status quo* as unwieldy, complicated and full of unnecessary devices:

> To receive streaming Internet video, it is necessary to have a smart TV, or to watch it on a tablet or laptop computer that, similarly, do not have access to the channels and content that pay-TV subscribers pay for. The result is multiple devices and controllers, constrained program choice and higher costs.[73]

This "too many remotes" claim is simply spurious. Universal remotes have long existed, and the notion that we need a morass of new rules that will further complicate the business networks that support the creation and distribution of video, and ultimately gener-

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[71] *See* Eli Parisier, *Did Facebook's New Study Kill My Filter Bubble Thesis?*, BACKCHANNEL (May 7, 2015), https://backchannel.com/facebook-published-a-big-new-study-on-the-filter-bubble-here-s-what-it-says-ef31a292da95#.nrthcopuw.

[72] The top 10 results for a web search receive over 91% of total traffic related to that search, and by page three the figure drops to under 1%. Thus, the costs of not being in the top 10–a reality that a particularly niche channel will face short of highly specific searches–are very large when taken out of a programming neighborhood. Jessica Lee, *No. 1 Position in Google Gets 33% of Search Traffic*, SEARCH ENGINE WATCH (Jun. 23, 2013), https://searchenginewatch.com/sew/study/2276184/no-1-position-in-google-gets-33-of-search-traffic-study.

[73] Tom Wheeler, *It's Time to Unlock the Set-Top Box Market*, RE/CODE (Jan. 27, 2016), http://recode.net/2016/01/27/its-time-to-unlock-the-set-top-box-market/.

ate higher costs for consumers, in order to reduce the number of remote controls a consumer needs to manage is absurd.

The upshot of the proposed rules is that an unknown number of competitors with no obligations to any party in the current set of contracts will be able to modify and redistribute the content that emerges from those negotiations. Thus, ongoing negotiations between MVPDs, programmers, and rights holders will need to account for the uncontrollable and uncertain presence of an unknown number of third-parties. This simply *must* complicate and cloud the calculations that each party performs along the various stages of negotiation, and will generate additional costs as parties attempt to mitigate losses arising from third-party activity. Some portion of these costs will be necessarily passed on to consumers, and there is every reason to believe that these costs will far outweigh the relatively trivial costs consumers incur today for set-top box rental.

Moreover, the additional transaction costs added to the negotiations will likely be for no realized gains. Consumers will be able to access the same content they have access to today (or *less* content), simply through a different technical delivery mechanism (and, at best, with a different—but not necessarily better—user interface containing additional advertising added in).

Effects on content: Removing competing distributors and violating copyrights

The rules proposed here are not merely unnecessary, they would also very likely work to reverse the pro-consumer developments that have been emerging in the video market over the last twenty years. In at least the short- and medium-terms, the incentives provided under the proposed rules will encourage new entrants (or existing OVD providers considering expansion into linear programming) to opt to centralize their services around cable-provided streams, rather than negotiate with content producers for smaller bundles or even more innovative arrangements. By making it more economical to merely repackage MVPD content, the rules make a number of possible innovative alternatives more expensive by comparison, and thus less likely to be tried. For all the rules' focus on *interface* innovation (which is nowhere to be found in the statute), they sacrifice content and video-distribution innovation in the process. It is disappointing that in the name of increasing competition for access to video content the FCC proposes a set of rules that with almost inevitably have the opposite effect.

The reason is relatively simple and perfectly rational: The costs associated with acquiring content are rather high, and the process is complicated. If a provider can skip the hard work and expense associated with negotiating with content creators, but still derive ad revenue, she will, of course, jump at the chance. But free riding has consequences. The end result will be less innovation in providing video choice to consumers and more reliance on traditional MVPD streams, further entrenching the power of large incumbents (whether the old-guard MVPDs or the new-guard online media platforms).

It's ironic that Public Knowledge and other supporters of the NPRM argue that the MVPD programming bundle is the major impediment to disruptive competition in the market, because the primary effect of the proposed rules will likely be to reinforce the large bundle.[74] Among other things, Public Knowledge has claimed that "[m]ost of the most popular programming is not available except through traditional subscription TV services, and these grow more expensive year after year."[75] This claim is wrong on both counts. As a recent SNL Kagan Report found,

> There is a high proportion of most popular, critically acclaimed and independent films and TV series available through dozens of online services. We found that 98% of premium films and 94% of premium TV series were digitally available on at least one of the online services we reviewed (including online VOD and TV Everywhere on-demand services).
>
> Most popular, critically acclaimed and independent films and TV series are widely available online to U.S. consumers. The findings show that the online availability of popular and critically acclaimed films was not limited to one or a few online services. We found that 95% of premium films and 84% of premium TV series were digitally available on at least five of the online services we reviewed.[76]

This is a remarkable amount of competition for the video content available on MVPD services, and it demonstrates that the most popular programming is most definitely widely available without "traditional TV subscription services."

Likewise, as noted above, in the absence of interventions like the one contemplated here, the price of pay TV subscriptions has been *falling*, not rising: Per-channel cable

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[74] *See Hearing on The State of Video: Before the Subcomm. on Commc'ns, Tech., & the Internet of the S. Comm. on Commerce, Science, & Trans.*, 113th Cong. 10–11 (2013) (statement of John Bergmayer, Senior Staff Attorney, Public Knowledge) at 2, *available at* https://www.publicknowledge.org/files/State%20of%20Video%20Senate%20Hearing%20-%20PK%20Testimony%205-14-13.pdf ("[D]espite all of the great programming and groundbreaking devices, many Americans are locked into a television business model that limits competition and choice: the expensive bundle of channels.").

[75] *Id.*

[76] SNL KAGAN, U.S. AVAILABILITY OF FILM AND TV TITLES IN THE DIGITAL AGE 4 (March 2016), *available at* http://go.snl.com/rs/080-PQS-123/images/U.S.%20Availability%20of%20Film%20and%20TV%20Titles%20in%20the%20Digital%20Age.pdf.

prices have fallen precipitously since 1994.[77] When Chairman Wheeler and others cite contrary numbers they are comparing 1990s apples (low-resolution cable with limited programming on few channels) with today's oranges (440 channels of high-definition cable, on-demand programming, and a host of other features).[78] But in terms that allow an apples-to-apples comparison, there is no dispute that prices have fallen.

On the other hand, if content owners lose control over the manner in which their content is presented due to the ability of third-parties to ignore key contractual restrictions and to insist on parity, this *could* make MVPDs less powerful, as content owners react by reducing the amount of high-value content they choose to license to MVPDs. But the result is the same: In such a world dominant OVD services will exercise considerable power, as content providers have already expressed a strong preference for controlling the channels of distribution as they are found today. In fact, it is presumably the case that large, online companies support this NPRM precisely because they expect and intend to offer, effectively, a *replacement* platform for MVPDs' full, traditional, linear and on-demand content—ultimately by licensing content directly. In the short-run, however, the NPRM's free, compulsory license presents them with an opportunity to obtain content at low cost by regulatory fiat.

And, moreover, the OVD distributors will exercise their dominance outside the scope of FCC regulations. Thus, the end result may simply be a similar competitive dynamic, only with a few dominant OVD providers substituting for today's MVPDs, and with less regulatory oversight by the FCC. There is no reason to expect any more or better content or innovation in distribution in such an environment. Moreover, effecting such a change merely enriches a few OVD services at the expense of MVPDs, without obvious corresponding consumer benefit. Not only does that not serve the public interest, it goes far beyond the FCC's narrow statutory mandate to assure the commercial availability of unaffiliated navigation devices.

In either case, the rules would also reduce the number of distribution outlets negotiating for content placement, which would further short-circuit the development of the market for content and undermine the relative roles of producers and distributors in the current ecosystem.

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[77] *See* Report on Cable Industry Prices, *In the Matter of Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992 & Statistical Report on Average Rates for Basic Service, Cable Programming Service, and Equipment*, MM Docket No 92-266, at ¶ 17, Table 3 (Dec. 15, 2014), *available at* https://apps.fcc.gov/edocs_public/attachmatch/DA-14-1829A1.pdf#page=10.

[78] *See The Future of Video Marketplace Regulation*, at 8-11, Testimony of Geoffrey A. Manne, on "The Satellite Television Law: Repeal, Reauthorize, or Revise?" Before the House of Representatives' Energy and Commerce Committee (Jun. 12, 2013), *available at* http://docs.house.gov/meetings/IF/IF16/20130612/100960/HHRG-113-IF16-Wstate-ManneG-20130612-U1.pdf.

At best, the rules would merely effect a wealth transfer from MVPD providers and content companies to third-party set-top box providers by pushing the licensing revenues out of MVPD networks and into third-party ad networks.

The rules force MVPDs to violate copyright law in a number of ways.

According to the NPRM, "nothing in our proposal will change or affect content creators' rights or remedies under copyright law."[79] In fact, this is not even superficially true. Instead, the NPRM explicitly requires the abrogation of content creators' rights embedded in licenses negotiated with MVPD distributors to the extent that they conflict with the terms of the rule (as many of them must). Therefore, because such nullification of license terms interferes with content owners' right "to do and to authorize" their distribution and performance rights,[80] the rules may facially violate copyright law.

But even if the rules avoid these fundamental violations of copyright law, they manifestly contemplate that compliance will require interference with any contrary contract terms, and the mandatory sharing of content without license. In these ways, the rules require MVPDs to abrogate content creators' bargained-for rights under the Copyright Act.

And even if third-parties do not use MVPD content as a lure for pirated or other infringing content—which could be a copyright violation itself—the rules will create a contractually unhinged environment in which MVPDs are powerless to ensure that their guarantees to content providers are actually respected.

Ironically, this too may lead to content providers removing or reducing the programming they currently provide to MVPDs, and moving toward direct negotiations with OVD providers. Not only does that entirely undermine the rules (which are dependent on MVPD content), but it could enormously multiply the transactions costs of content distribution, entrench dominant OVD services, and ultimately lead to further fragmentation and higher costs. To be sure, there are always "solutions." Congress (but *not* the FCC, of course) could legitimately create a compulsory licensing scheme, for example. But the clear effect is to dramatically increase complexity, cost and the need for an intrusive regulatory apparatus.

Regardless of whether or how well the rules effect the purpose of Sec. 629, copyright violations cannot be justified by recourse to the Communications Act. Provisions of the Communications Act—enacted under Congress's Commerce Clause power—cannot be used to create an end run around limitations imposed by the Copyright Act under the

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79 NPRM at ¶ 80.

80 17 U.S.C. § 106.

Constitution's Copyright Clause. "Congress cannot evade the limits of one clause of the Constitution by resort to another,"[81] and thus neither can an agency acting within the scope of power delegated to it by Congress. Establishing a regulatory scheme under the Communications Act whereby compliance by regulated parties forces them to violate content creators' copyrights is plainly unconstitutional.

Further, the FCC is subordinate to Congress, and as such cannot enact rules that nullify statutory rights created by Congress. Thus, the exclusive rights of Section 106 of the Copyright Act—apart from any constitutional concerns—cannot be abrogated by FCC diktat. Forcing MVPDs to transmit their video streams without permission from rights holders requires MVPDs to violate content owners' exclusive right to determine the terms by which their content will be distributed. Similarly, by mandating that third-parties can retransmit copyrighted content on almost any terms they choose without permission from rights holders, the FCC is creating a system premised on the violation of rights holders' exclusive right to determine the terms by which their content will be publicly performed.

In effect, the rules saddle content owners with a zero-rate compulsory license—something the FCC is unambiguously not authorized to do under Section 621 of the Communications Act.[82] Such a result is imposed in opposition to the policy choices that Congress has expressed in the Copyright Act by *not* creating a compulsory license or other exemption related to MVPD streams, and is therefore outside of the Commission's prerogative.[83]

Finally, it must be noted that nothing in the NPRM, despite its lip service to "content protection," facilitates the avoidance of these copyright violations. The NPRM notes that

> [u]naffiliated vendors must implement content protection to ensure that the security of MVPD services is not jeopardized, and must respect licensing terms regarding copyright, entitlement, and robustness. This will ensure parity between MVPD-provided and competitive navigation devices.[84]

But respecting "licensing terms regarding copyright, entitlement, and robustness" *may* mean that third-parties can't copy or *further* distribute copyrighted content, but it does

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[81] Kristian Stout, *Copyrights Without Limits: The Undefeatable Right of Access Control Under §1201(A) of the Digital Millennium Copyright Act*, 19 MARQUETTE INTELL. PROP. L. REV. 181, 198 (2015).

[82] 47 U.S. Code § 541.

[83] 17 U.S. Code § 111 contains detailed examples of limitations on the exclusive rights granted under Section 106—none of which remotely resembles the requirements that the proposed rules would impose.

[84] NPRM at ¶ 29.

not do anything to mitigate the license violation inherent in MVPDs' providing, and third-parties performing, content in the first place.[85]

But more significantly, it undermines a content owner's ability to impose any more fine-grained restrictions or to receive compensation. Copyright is not simply about preventing direct copying; it is about conferring on content owners the ability to *commercialize* their works, which means giving them control over a wide range of things including marketing, distribution, quality, and the like, as well as the ability to receive compensation for access to their works. Nothing in the NPRM would secure these more detailed rights beyond, essentially, copyright's basic reproduction and performance entitlements (secured in the NPRM through copy and output control obligations).[86] And, most important, nothing in the NPRM would enable compensation for such access, except indirectly by programmers increasing licensing fees to MVPDs in the first place.

The rules require MVPDs to disregard their contractual obligations.

The NPRM states that:

> We also seek specific comment on the process that an MVPD uses to decide whether to allow such a device to access its services…. Do programmers prohibit MVPDs from displaying their programming on certain devices? If so, what are the terms of those prohibitions? Should the Commission ban such terms to assure the commercial availability of devices that can access multichannel video programming, and under what authority?[87]

The ability of programmers to, for example, limit the devices on which their content may be displayed is in large part a function of their copyrights. These sorts of specific licensing limitations can't be separated from the basic entitlements under the Copyright Act, as if they are any less a part of the set of rights Congress has reserved for creators under the Act.

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[85] It is clear from how it is used elsewhere (or not used) that "copyright" here mean "direct copying." The conclusion in the footnoted paragraph assumes that existing contracts between MVPDs and content creators negotiated under the CableCARD regime are insufficient to confer on MVPDs the contractual rights required to effect the NPRM's regime. This seems extremely likely given the differences between CableCARD and the proposed rules. Regardless, under CableCARD it is generally the case that third-parties are obligated to respect contractual provisions that bind MVPDs and content creators—something that the proposed rules do nothing to assure.

[86] *Cf.* NPRM at ¶ 39. The NPRM does also include protection for video resolution, which is an aspect of quality, of course. But there are others (including, e.g., limits on permissible advertising) that are not considered.

[87] NPRM at ¶ 18.

The Commission claims authority to interfere with contracts between programmers and MVPDs in order to fulfill what it asserts Section 629 requires: Promotion of "competition in interfaces, menus, search functions, and improved over-the-top integration" in the set-top box market.[88] But Section 629 does not, on its face, specify any particular sort of advanced product—let alone one based on compulsory unbundling of MVPDs' products and the consequent abrogation of contract terms.

Disparate and unreasonable regulatory treatment

As structured, the rules will place a regulatory thumb on the scale in favor of third-parties and to the detriment of MVPDs and programmers. Third-party set-top box providers will be permitted to access and repackage content without having to be subject to any of the obligations that MVPDs undertake by virtue of their negotiations for that content. Thus, the rules externalize the transaction costs that the third-parties would otherwise have to bear onto MVPDs, and allow those third-parties to free ride on their efforts.

The effect is not limited strictly to the consumption of MVPD content, either. Third-parties will be able to repackage MVPD content alongside their own, thus using MVPD content as a cost-free draw to their own properties where they can then monetize viewers through advertising and other means. Such a scheme also provides third-parties with an enormous windfall in the form of user data, without forcing those companies to comply with the same restrictions on user-data collection and use that MVPDs face from the Commission.[89] Indeed, the Commission is actually *powerless* to impose any real privacy restrictions on third-party set-top box makers, as the Communications Act privacy provision reaches only to cable operators and DBS providers, and grants only a private right of action, in any case.

Importantly, much of this is made possible, or made attractive to third-parties, because the proposal is not limited to conveying MVPD content to competing devices in the same format it is presented by MVPDs. The NPRM claims that

> We do not currently have evidence that regulations are needed to address concerns raised by MVPDs and content providers that competitive navigation solutions will disrupt elements of service presentation (such as agreed-upon channel lineups and neighborhoods), replace or alter advertising, or improperly manipulate content. We have not seen evidence of any such problems in the

[88] NPRM at ¶ 17.

[89] *See, e.g.*, 47 U.S.C. § 551; 47 U.S.C. § 338(i).

> CableCARD regime, and based on the current record, do not believe it is necessary for us to propose any rules to address these issues.[90]

This is disingenuous for several reasons. The whole *point* of "competitive navigation services" is to "disrupt elements of service presentation." But Section 629 was clearly not about this at all; it was about ensuring that non-affiliated OEMs could provide set-top boxes, presumably to protect against feared monopolization by MVPDs of this secondary market.[91] By reinterpreting the statute to incorporate a contrived user-interface innovation mandate, the Commission invites third-parties to reimagine MVPDs' services. While we can all appreciate the intended result—set-top box user-interface innovation—the statute itself provides no authority for the FCC to pursue such a goal.

At the same time, the absence of evidence of copyright and contract violations in the CableCARD regime is hardly very telling when the regime is roundly condemned by the Commission as incapable of providing meaningful "competitive navigation solutions," and when it incorporates a requirement that

> a retail navigation device developer must negotiate with MVPDs to get permission to provide access to the MVPD's multichannel video programming, on the MVPD's terms. These business-to-business arrangements… have increased the universe of devices [consumers] can use to receive service. The arrangements have not assured a competitive retail market for devices from unaffiliated sources as required by Section 629 because they do not always provide access to all of the programming that a subscriber pays to access, and may limit features like recording. In other words, these business-to-business arrangements—typically in the form of proprietary apps—do not offer consumers viable substitutes to a full-featured, leased set-top box. Moreover, these relationships are purely at the discretion of the MVPD and, to date, have only provided access to the MVPD's user interface rather than that of the competitive device.[92]

There is disagreement over why, exactly, CableCARD was a failure, but general agreement that it was. Nevertheless the Commission chooses to adopt, essentially in their entirety, the various criticisms of CableCARD offered by Free Press (among other regulatory advocates) in its comments to the Commission in the 2010 AllVid proceeding.[93] Not surprisingly, the criticisms lay the blame primarily at the MVPDs' feet ("[t]he cable

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[90] NPRM at ¶ 80.

[91] Of course the idea itself is economically unsound. CITE literature re single monopoly price, tying, etc.

[92] NPRM at ¶ 16.

[93] *See, e.g.*, Comments of Free Press, *In the Matter of Video Device Competition*, MB Docket No. 10-91, July 13, 2010, *available at* http://www.freepress.net/sites/default/files/fp-legacy/Allvid_Comments_07132010.pdf.

industry played a prominent role in impeding the potential success of CableCARD")[94] most notably for impeding the coordination and negotiations required by the CableCARD regime.

Commissioner Pai, on the other hand, lays the blame at the Commission's feet (for a sin, it must be noted, that it stands poised to replicate with these proposed rules):

> Let's start with one indisputable fact: When it comes to navigation devices, the FCC has not embraced free-market policies. Instead, it has embraced a form of centralized planning. By implementing the CableCARD regime and the integration ban, the FCC sought to mold the set-top box marketplace to its desired shape. But there is widespread agreement that the Commission's regulatory intervention has been a massive failure. Indeed, this Notice repeatedly admits the rules failed to achieve their objective.[95]

That negotiation and permission are viewed by the Commission as inherent defects of the status quo *is* telling. Rather than viewing the absence of evidence of contract and copyright violations under CableCARD as a possible rare high point in an otherwise bleak experiment, the Commission identifies them as defects standing in the way of its manufactured "interface innovation" requirement. This isn't "parity."

The Commission's reading of Section 629's unambiguous language is unreasonable.

The NPRM also disregards the plain language of Section 629, which, in contrast to the Commission's unreasonable interpretation of it, unambiguously requires rules that, stripped to their essentials, ensure the "availability, to consumers… of… equipment used [by them] to access multichannel video programming and other services offered [by MVPDs], from [unaffiliated] manufacturers."

The Commission reads its claimed authority primarily into the mandate to ensure "commercial availability." That is to say, for the Commission, "commercial" viability for third-party devices requires not just that they offer MVPDs' content and services as the MVPDs do, but also that they have the ability to freely manipulate and innovate around the disaggregated building blocks of MVPDs' offerings:

> [W]e do not believe that the current marketplace provides the "commercial availability" of competitive navigation devices by manufacturers, retailers, and other vendors not affiliated with any MVPD that can access multichannel video programming within the meaning of Section 629. Given our experience to

[94] *Id.* at 3.

[95] Dissenting Statement of Commissioner Ajit Pai, NPRM at 61.

> date, we believe that Section 629 cannot be satisfied—that is, we cannot assure a commercial market for devices that can access multichannel video programming—unless companies unaffiliated with an MVPD are able to offer innovative user interfaces and functionality to consumers wishing to access that multichannel video programming.[96]

This baldly misconstrues a term plainly meant to refer to the manner in which consumers obtain their navigation devices, not how those devices should function. It also contradicts the Commission's own, prior readings of the statute. For example, the Commission noted in the first paragraph of its first rulemaking under Section 629 in 1998 that "[t]he purpose of Section 629… is to expand opportunities to purchase this equipment from sources other than the service provider."[97] Moreover, it reads into the statute a mandate for a particular, specific mechanism to achieve what the Commission claims "commercial availability" requires without demonstrating that this particular mechanism is, in fact, the only way to achieve it.

The Commission takes liberties with the unambiguous, plain language of the statute in several ways.

- *Availability*, even "commercial" availability, is neutral. It requires that consumers can get devices, and do so through normal channels of commerce. It does not contemplate that these devices must have any particular attribute, nor does it imply an unstated preference for innovation (or anything else).
- *Equipment* (and devices, etc.) generally means physical things—set-top *boxes*. That devices typically run software is irrelevant: By its plain language the statute seeks to promote a consumer market in devices, not an OEM market for the software that runs on devices.
- And *programming and services offered* to consumers means just that: the programming and services actually *offered* to consumers. It does not mean some disaggregated version of the content MVPDs receive from programmers and the services they create themselves. MVPDs *offer* consumers only a finished product combining these elements.

None of this is reflected in the NPRM, however.

The proposed rules also suffer from logical inconsistencies. As noted, the Commission is effectively basing this NPRM on the idea that "universal" set-top boxes represent a

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[96] NPRM at ¶ 25.

[97] Report and Order, *In the Matter of Implementation of Section 304 of the Telecommunications Act of 1996: Commercial Availability of Navigation Devices*, CS Docket No. 97- 80, at ¶ 1 (June 24, 1998).

completely separate market from the general market for video consumption (the MVPD and OVD markets collectively).

But consumers are "voting with their feet" by defecting from large MVPD packages, indicating that they view MVPD and OVD offerings as substitutes. Yet, the proposed rules would privilege—or at least make highly attractive—OVDs offering MVPD bundles by reducing the transaction costs associated with acquiring this video programming. Far from making the playing field level, it tilts the entire game, and encourages the market's negotiated progress toward apps and *a la carte* services to reverse and gravitate toward compulsory-licensed and repackaged MVPD content.

Further, the integrated video experience that drives the Commission's logic is more or less beyond reach. So long as third-parties are not required to contribute their own original video streams to each other (and to MVPDs, of course), there *can't* be universal access to content (e.g., content exclusive to Netflix won't appear on Amazon and won't appear on Xfinity, either). The "universal" access to video content envision by the NPRM is actually arbitrary and decidedly *not* universal.

Conclusion: Pandora's set-top box

The NPRM reflects a Commission failing to exercise appropriate regulatory humility and risking considerable consumer harm as a consequence.

The web of contracts that support the creation and distribution of content are complicated, extensively negotiated, and subject to destabilization. Abrogating the parties' use of the various control points that support the financing, creation, and distribution of content would very likely reduce the incentive to invest in new and better content, thereby rolling back the golden age of television that consumers currently enjoy.

Further, by disrupting the negotiated expectations of the various parties in the MVPD-content ecosystem, the current sources of financing become uncertain. This will encourage a greater reliance on a larger network of advertising, and where content producers continue to face uncertain markets, greater in-program marketing and advertising messages. The result would be a larger percentage of marketing content embedded in original material.

The rules also open up troubling questions around privacy and consumer data. Third-parties would not be subject to the Act's privacy regulations, and the proposed rules could be redirecting consumers out of a predictable, regulated environment and into a digital ecosystem in which their video viewing habits can be correlated with their larger web-usage behavior.

The market has already begun moving substantially toward an apps-based and more *a la carte* model; prying open access to MVPD content is likely to backfire on the larger objective of increasing competition in video markets by encouraging marginal repackaging of MVPD content bundles and less innovation overall.

The rules would compel MVPDs to provide what amounts to a zero-rate compulsory license to all-comers. Moreover, it must provide these compulsory licenses to parties who do not have to comply with any of the contractual provisions binding MVPDs, thus creating a large number of unforeseen loopholes that would frustrate the extensive negotiations that go into the creation of content. And placing providers in a position where they are compelled to violate copyright law in order to comply with the rules (or vice versa) is a formula for a dramatic court loss.

All of the foregoing leads to a final question: At what point do the costs of these rules finally outweigh the perceived benefits? On the one hand are legal questions of infringement, inducements to violate agreements, and disruptions of complex contractual ecosystems supporting content creation. On the other hand are the presence of more boxes and apps that allow users to choose who gets to draw the UI for their video content. And ultimately, after all those costs are incurred, the market may not look appreciably different than it does today; only the names of the companies from which consumers buy their video subscriptions may change. At some point the Commission needs to take seriously the costs of its actions, and determine whether the public interest is really served by the proposed rules.