Opening Pandora's set-top box: ICLE's comments on the FCC's "unlocking the box" NPRM
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On Friday the the International Center for Law & Economics filed comments with the FCC in response to Chairman Wheeler's NPRM (proposed rules) to "unlock" the MVPD (i.e., cable and satellite subscription video, essentially) set-top box market. Plenty has been written on the proposed rulemaking—for a few quick hits (among *many* others) see, e.g., Richard Bennett, Glenn Manishin, Larry Downes, Stuart Brotman, Scott Wallsten, and me—so I'll dispense with the background and focus on the key points we make in our comments.

Our comments explain that the proposal's assertion that the MVPD set-top box market isn't competitive is a product of its failure to appreciate the dynamics of the market (and its disregard for economics). Similarly, the proposal fails to acknowledge the complexity of the markets it intends to regulate, and, in particular, it ignores the harmful effects on content production and distribution the rules would likely bring about.

"Competition, competition, competition!" — Tom Wheeler

"Well, uh… just because I don't know what it is, it doesn't mean I'm *lying.*" — Claude Elsinore

At root, the proposal is aimed at improving competition in a market that is already hyper-competitive. As even Chairman Wheeler has admitted,

> 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.

Of course, much of this competition comes from *outside* the MVPD market, strictly speaking—most notably from OVDs like Netflix. It's indisputable that the statute directs the FCC to address the MVPD market and the MVPD set-top box market. But *addressing* competition in those markets doesn't mean you simply disregard the world outside those markets.

The competitiveness of a market isn't solely a function of the number of competitors in the market. 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 (all of which are presumed by the Commission to be subject to “effective competition”).

The truly troubling thing, however, is that the FCC *knows* that MVPDs compete with OVDs, and thus that the competitiveness of the “MVPD market” (and the “MVPD set-top box market”) isn’t solely a matter of direct, head-to-head MVPD competition.

How do we know that? As I’ve recounted before, in a recent speech FCC General Counsel Jonathan Sallet approvingly explained that Commission staff recommended rejecting the Comcast/Time Warner Cable merger precisely because 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….

Thus, at least when it suits it, the Chairman’s office appears not only to believe that this competitive threat is real, but also that *Comcast*, once the largest MVPD in the country, believes so strongly that the OVD competitive threat is real that it was willing to pay *$45 billion* for a mere “increased ability” to limit it.

UPDATE 4/26/2016

And now the FCC has approved the Charter/Time Warner Cable, imposing conditions that, according to Wheeler,

> focus on removing unfair barriers to video competition. First, New Charter will not be permitted to charge usage-based prices or impose data caps. Second, New Charter will be prohibited from charging interconnection fees, including to online video providers, which deliver large volumes of internet traffic to broadband customers. Additionally, the Department of Justice’s settlement with Charter both outlaws video programming terms that could harm OVDs and protects OVDs from retaliation—an outcome fully supported by the order I have circulated today.

If MVPDs and OVDs don’t compete, why would such terms be necessary? And even if the threat is merely *potential* competition, as we note in our comments (citing to this, among other things),

> 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.

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Moreover, the proposal asserts that the "market" for MVPD set-top boxes isn't competitive because "consumers have few alternatives to leasing set-top boxes from their MVPDs, and the vast majority of MVPD subscribers lease boxes from their MVPD."

But the MVPD set-top box market is an aftermarket—a secondary market; no one buys set-top boxes without first buying MVPD service—and always or almost always the two are purchased at the same time. As [Ben Klein]() and many others have shown, direct competition in the aftermarket need not be plentiful for the market to nevertheless be competitive.

> Whether consumers are fully informed or uninformed, consumers will pay a competitive package price as long as sufficient competition exists among sellers in the [primary] market.

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.

The proposal's superficial and erroneous claim that the set-top box market isn't competitive thus reflects bad economics, not competitive reality.

But it gets worse. The NPRM doesn't actually deny the importance of OVDs and app-based competitors wholesale — it only does so when *convenient*. As we note in our Comments:

> 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… In order to avoid triggering [Section 629's sunset provision,] 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.

"Yes, but you're aware that there's an invention called television, and on that invention they show shows?" — [Jules Winnfield]()

The NPRM proposes to create a world in which all of the content that MVPDs license from programmers, and all of their own additional services, must be provided to third-party device manufacturers under a zero-rate compulsory license. Apart from the *complete* absence of statutory authority to mandate such a thing (or, I should say, apart from statutory language specifically *prohibiting* such a thing), the proposed rules run roughshod over the copyrights and negotiated contract rights of content providers:

> The current rulemaking represents an overt assault on the web of contracts that makes content generation and distribution possible… 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…

> Because such nullification of license terms interferes with content owners' right "to do and to authorize" their distribution and performance rights, the rules may facially violate copyright law… [Moreover,] 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.

You'll be hard-pressed to find any serious acknowledgement in the NPRM that its rules could have any effect on content providers, apart from this gem:

> 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 also seek comment on the extent to which copyright law may protect against these concerns, and note that nothing in our proposal will change or affect content creators' rights or remedies under copyright law.

The Commission can't rely on copyright to protect against these concerns, at least not without admitting that the rules require MVPDs to violate copyright law and to breach their contracts. And in fact, although it doesn't acknowledge it, the NPRM *does* require the abrogation of content owners' rights embedded in licenses negotiated with MVPD distributors to the extent that they conflict with the terms of the rule (which many of them must).

"You keep using that word. I do not think it means what you think it means." — Inigo Montoya

Finally, the NPRM derives its claimed authority for these rules from an interpretation of the relevant statute (Section 629 of the Communications Act) that is absurdly unreasonable. That provision requires the FCC to enact rules to assure the "commercial availability" of set-top boxes from MVPD-unaffiliated vendors. According to the NPRM,

> we cannot assure a commercial market for devices… unless companies unaffiliated with an MVPD are able to offer innovative user interfaces and functionality to consumers wishing to access that multichannel video programming.

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:

> 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…. [But] Congress *explicitly* rejected language that would have required unbundling of MVPDs' content and services in order to promote other distribution services…. 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.

And despite the above noted problems (and more), the Commission has failed to do even a cursory economic evaluation of the relative costs of the NPRM, instead focusing narrowly on one *single* benefit it believes might occur (wider distribution of set-top boxes from third-parties) despite the consistent failure of similar FCC efforts in the past.

> 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…. 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.

Our full comments are available here.

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