United States Government Accountability Office

Report to the Acting Chairwoman of the Federal Communications Commission

June 2013

VIDEO MARKETPLACE

Competition Is Evolving, and Government Reporting Should Be Reevaluated

GAO-13-576

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GAO Highlights

Highlights of GAO-13-576, a report to the Acting Chairwoman of the Federal Communications Commission

Why GAO Did This Study

Video provided through subscription video services, such as cable and satellite television, is a central source of news and entertainment for the majority of U.S. households. Technological advances have ushered in a wave of new products and services, bringing online distribution of video to consumers. Federal laws and regulations have sought to foster competition in the video programming and distribution marketplace, but many such laws were adopted prior to the emergence of these advances.

Among other things, GAO examined (1) how competition has changed since 2005; (2) the increased choices that consumers have in acquiring video programming and content; and (3) stakeholders' views on how the government's regulations, reports, and other activities have kept pace with changes in the industry. GAO reviewed relevant literature and reports; interviewed agency officials, industry stakeholders, and experts; and analyzed prices and service offerings in 20 randomly sampled zip codes (the prices and services offerings reflect conditions in the 20 zip codes and are not generalizable to all zip codes).

What GAO Recommends

FCC should study the advantages and disadvantages of different reporting frequencies for its cable industry price and video competition reports and transmit the results of its analysis to Congress. FCC said that the Commission strives to use its resources efficiently to meet the agency's mission and its Congressional requirements, and the Commission is reviewing GAO's recommendation.

View GAO-13-576. For more information, contact Mark Goldstein at (202) 512-2834 or goldsteinm@gao.gov.

What GAO Found

Since GAO reported on competition in 2005, competition among video content producers is little changed, while competition among distributors has increased. According to data cited by the Federal Communications Commission (FCC), seven companies' broadcast and cable networks accounted for about 95 percent of all television viewing hours in the United States. Further, ownership of broadcast and cable networks changed little from 2005 through 2012. Alternatively, the introduction of video service provided by telephone companies, such as Verizon's FiOS service, has brought additional competition to video distribution. At year-end 2010, roughly 1 in 3 households could choose among 4 or more subscription video distributors: typically a cable company, 2 satellite companies, and a telephone company. With technological advances, companies are increasingly distributing video online. Online video distributors (OVD) are developing a variety of business models, including free and subscription-based services. However, online viewing and revenues represent a small portion of overall media viewing hours and revenue.

Consumers continue to acquire programming and content through packages, but OVDs are delivering new choices. All the video distributors that GAO analyzed required consumers to purchase a package of channels often through the basic, expanded basic, and premium tiers. According to FCC data, in 2011, the average price for expanded basic service was $57.46, and had increased over 33 percent since 2005, exceeding the 15 percent increase in the Consumer Price Index. OVDs and other companies allow consumers to select content on a program or episode basis. However, these services typically do not include the most recent television programs and movies, thereby limiting their value for some consumers.

Stakeholders generally noted that laws and regulations have not kept pace with changes in the video industry, and FCC has not consistently reported on competition. Some legislation governing the media industry was adopted over 20 years ago, before telephone companies entered the marketplace and the commercialization of the Internet facilitated new OVD services. A majority of stakeholders with whom GAO spoke stated that some provisions should be revisited. FCC is required to annually report to Congress on cable industry prices and competition in the video marketplace. However, since 1992, FCC has not published the cable industry price report 4 times—in 2004, 2006, 2007, and 2010—and has not published the video competition report 4 times—in 2007, 2008, 2010, and 2011. According to FCC officials, a variety of administrative factors contributed to the missed reports, and the reports are time consuming to prepare. The reports also impose burdens on some industry participants.

Less frequent reporting on cable industry prices and competition in the video marketplace could allow for continued measurement of industry performance while reducing the burden on FCC and industry participants. GAO found little change in the reported findings from year-to-year in FCC's video competition report. FCC's 2009 cable industry price and 2012 video competition reports followed missed reports, and these reports included data covering multiple years; these reports could serve as a model for issuing such reports less frequently. Since these reports are statutorily required, Congress, with input from FCC, would need to determine any new reporting frequency.

Contents

Abbreviations

CPST	cable programming service tier
DBS	direct broadcast satellite
DOJ	Department of Justice
FCC	Federal Communications Commission
FTC	Federal Trade Commission
IP	Internet protocol
MFN	most-favored nation
MVPD	multichannel video programming distributor
NCTA	National Cable and Telecommunications Association
OVD	online video distributor

U.S. GOVERNMENT ACCOUNTABILITY OFFICE
441 G St. N.W.
Washington, DC 20548

June 25, 2013

The Honorable Mignon Clyburn
Acting Chairwoman
Federal Communications Commission

Dear Chairwoman Clyburn:

Video provided through cable and satellite television services is a central source of entertainment, news, and other information for most American households. Today, over 100-million U.S. households subscribe to and rely on these television services, viewing on average more than 140 hours of content every month. Federal laws and regulations, including the Cable Television Consumer Protection and Competition Act of 1992 and the Telecommunications Act of 1996, sought to foster competition in the video programming and distribution marketplace. These laws and regulations were essential to the emergence and growth of direct broadcast satellite (DBS) television service in the late 1990s and early 2000s, which saw DBS companies gain market share at the expense of traditional cable companies. More recently, competition from new entrants—most prominently traditional telephone companies—has increased in some areas of the country. In addition, advances in digitalization and Internet infrastructure have ushered in a wave of new products and services, bringing online distribution of video through services such as Netflix and YouTube to consumers. Some consumer advocates, industry stakeholders, and policymakers have expressed concern that laws and regulations, first adopted in the 1990s, are no longer adequate to address changing competition in the emerging digital environment. And despite the myriad of technological and other changes, the rates paid by consumers for subscription video services continue to increase at a faster pace than the general rate of inflation.

We examined (1) how competition has changed since 2005; (2) the increased choices that consumers have in acquiring video programming and content; (3) the factors that can spur or hinder competition; and (4) stakeholders' views on how the federal government's regulations, reports, and other activities have kept pace with changes in the industry.

To address these questions, we reviewed relevant literature and reports published since 2005. In particular, we conducted a literature search and reviewed relevant articles on competition, technology, and economics in the video programming and distribution marketplace, including academic

journals and studies. We also reviewed relevant reports prepared by the Federal Communications Commission (FCC), the Department of Justice (DOJ), and the Federal Trade Commission (FTC). To identify the prices for cable service, we gathered data from FCC's Cable Industry Price reports for the years 2005 through 2012, which represent the most recent available data. We reviewed FCC documentation and information provided by FCC staff to assess the reliability of the cable price data and determined that FCC's data were sufficiently reliable for the purposes of our report. We conducted interviews with FCC and DOJ, industry associations and participants, and experts; we selected industry associations and participants to ensure a diversity of participants, including content companies, broadcast and cable networks, multichannel video programming distributors (MVPD)—cable, satellite, and telephone companies—and online video distributors (OVD). We reviewed relevant laws, regulations, and FCC proceedings, including Notices of Inquiry, Proposed Rulemakings, and Reports and Orders. To determine the level of competition, available packages and pricing, and other program options, we conducted an analysis of MVPD services in 20 randomly sampled zip codes across the United States; these zip codes represented dense, urban areas as well as sparsely populated rural areas. For each zip code, we identified the MVPDs providing service and collected information from the MVPDs on their services and prices. Our results reflect the competition, packages, and pricing in the 20 zip codes and are not generalizable to all zip codes. For more details on our scope and methodology, see appendix I.

We conducted this performance audit from July 2012 to June 2013 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

Video Programming and Distribution

Various entities and groups develop and distribute video content. Content producers, such as Sony Pictures Entertainment and CBS Television Studios, sell the right to use their content to a variety of users, such as broadcast networks, cable networks, and local television stations. The financial compensation received by content producers for the use of their

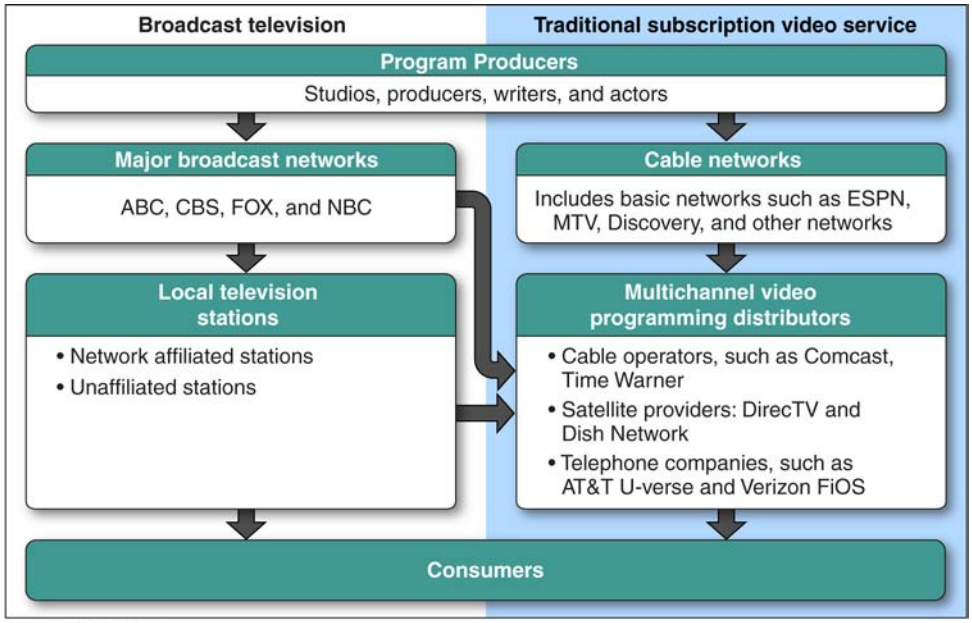
copyright-protected content is a licensing fee or royalty. Broadcast and cable networks produce and aggregate programming from other content producers for distribution to the public. Broadcast networks consist mainly of four major networks (ABC, CBS, FOX, and NBC), and several smaller networks, such as the CW Television Network, MyNetworkTV, and ION Television. Content is produced by the major networks' affiliated production companies, which can include movie and television studios, and independent producers. Cable networks aggregate programming from content producers and some also produce programming, which can include niche programming—that is, programming that targets specific demographics. For instance, Lifetime Television offers programming that specifically targets women, while MTV offers programming that targets the 18-to-34 age group.

Video content is distributed to households by local television stations, cable and satellite companies, and most recently, OVDs.[1] Each of the four major broadcast networks owns and operates some local television stations; other stations may be independently owned but affiliated with one of the major networks or, as is the case with noncommercial educational television, unaffiliated with any major network.[2] FCC licenses local television stations, which have the right to transmit a video broadcast signal on a specific radio frequency in a particular area and at a particular strength. Local television stations that are affiliated with a broadcast network negotiate licensing agreements with their network for the right to air network-furnished content, including prime time shows, afternoon soap operas, and national news programs. MVPDs obtain a variety of programming from both local stations and cable networks. Time Warner Cable, DISH Network, and Verizon are examples of cable, satellite, and telephone MVPDs, respectively, that license and distribute content to subscribers. Figure 1 illustrates how television programming is distributed through broadcast and traditional subscription video service.

[1]FCC described an OVD as any entity that offers video content by means of the Internet or another Internet Protocol-based transmission path provided by a person or entity other than the OVD. See, *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, MB Docket No. 07-269, Fourteenth Report, 27 FCC Rcd. 8610, 8612 (2012).

[2]Affiliated stations are stations not owned by a major broadcast network, but carry broadcast network programming and network-inserted advertisements during specific time periods.

Figure 1: Television Programming in Broadcast and Traditional Subscription Video Service



Sources: FCC and GAO.

Consumers can watch movies and television programs through computers, set top boxes, game consoles, and of course televisions. Some may also have the option of using tablets, smartphones, and other mobile devices to view content via the Internet, either through a MVPD service or an OVD, such as Netflix. Typically, the general public views television programming through broadcast or subscription video service. Local television stations provide free over-the-air programming to the public. In contrast, consumers pay fees to providers of subscription video services, including cable companies, satellite providers, or telephone companies. According to the National Cable and Telecommunications Association (NCTA), the trade association for cable companies, in 2012, over 85 percent of U.S. households had a MVPD subscription, with the remainder accessing television through an antenna.

Industry participants receive revenue from a variety of sources. Companies that create programming receive the majority of their revenue from license fees. Broadcast networks receive the majority of their revenue from advertising. Cable networks receive revenue from both monthly subscriber fees, paid by MVPDs, and advertising. MVPDs—which own, operate, and maintain their cable and satellite networks—receive the majority of their revenues from monthly subscription fees paid

by consumers, supplemented with advertising. Many MVPDs also provide broadband Internet and telephone services over their networks or in partnership with other companies.

Federal Laws, Regulations, and Responsibilities

FCC is an independent federal agency that regulates segments of the video marketplace. Among other things, FCC licenses local television stations, reviews certain proposed mergers of media companies, issues the cable industry price and video competition reports, conducts proceedings on media-related issues, and proposes, conducts, and implements rulemakings to encourage competition, localism, and video-programming diversity and to protect public safety and consumer welfare.[3] FCC derives its statutory authority from the Communications Act of 1934,[4] as amended by the following laws, among others:

- The Cable Communications Policy Act of 1984 sought to establish a national policy concerning cable service; franchise procedures and standards; and guidelines for federal, state, and local authorities to regulate cable service; among other things.[5] The 1984 Act imposed some limitations on franchising authorities' regulation of cable rates;[6] in particular, the 1984 Act restricted regulation to only basic cable service for cable systems not subject to effective competition as defined by FCC.[7]

- The Cable Television Consumer Protection and Competition Act of 1992 prohibited franchising authorities from awarding exclusive (or monopoly) franchises and required FCC to establish regulations

[3]The Department of Justice and Federal Trade Commission also review certain proposed mergers and investigate other potential antitrust violations. 15 U.S.C. §§ 1, 2, 18, 45 and 1311-14.

[4]Pub. L. No. 416, ch. 652, 48 Stat. 1064 (1934).

[5]Pub. L. No. 98-549, 98 Stat. 2780 (1984).

[6]Most wire-based MVPDs, such as cable companies, obtain a franchise to operate under agreed-upon terms and conditions from a local franchising authority, such as a township, county, or state. During cable's early years, franchising authorities regulated many aspects of cable television service, including subscriber rates.

[7]Cable companies offer basic cable and expanded basic services. Basic cable service generally includes local broadcast stations, education channels, and some cable networks. Expanded basic service includes all channels in basic cable service plus other cable networks like ESPN and Disney.

ensuring reasonable rates for both the basic cable service and the cable programming service tier (CPST), commonly referred to as expanded basic, for cable systems not subject to effective competition as defined by the Act; Congress passed the 1992 Act in response to increasing rates.[8] In addition, the 1992 Act required cable companies to carry all local television stations that requested carriage—known as *must carry*—or negotiate with television stations seeking compensation—known as *retransmission consent*. Cable companies that also produced content were required to provide their content to unaffiliated MVPDs at nondiscriminatory rates—known as *program access*.

- The Telecommunications Act of 1996 phased out regulation of rates for the CPST and included provisions that allowed for the growth of telephone companies in the video distribution marketplace.[9] For example, the 1996 Act eliminated the restriction on telephone companies providing video service directly to subscribers in areas where they provided telephone service.

Competition among Content Producers Is Little Changed, while Competition among Distributors Has Increased

Several Large Media and Entertainment Companies Produce Much of the Content Viewed In the United States

Several large media and entertainment companies continue to produce much of the content watched by consumers. According to a 2012 report cited by FCC, seven companies' broadcast and cable networks accounted for about 95 percent of all television viewing hours in the United States. These seven companies hold some combination of

[8]Pub. L. No. 102-385, § 2, 106 Stat. 1460 (1992).

[9]Pub. L. No. 104-104, 110 Stat. 86 (1996).

television and movie production studios, broadcast networks, and cable networks. The seven companies and some of their holdings include:

- *CBS:* CBS (broadcast network), CBS Television Studios, Showtime;
- *Discovery Communications:* Discovery Channel, TLC, A&E, Animal Planet;
- *Disney:* ABC (broadcast network), ESPN, Disney Channel, Walt Disney Studios;
- *NBCUniversal:* NBC (broadcast network), Universal Pictures, USA Network, Telemundo Television Studios, The Weather Channel;
- *News Corporation:* FOX (broadcast network), FOX News Channel, 20th Century Fox, 20th Century Fox Television;
- *Time Warner:* The CW Network (broadcast network), CNN, HBO, TBS, Warner Brothers Studios; and
- *Viacom:* MTV, Comedy Central, Nickelodeon, Paramount Pictures.

We previously reported that the major broadcast networks (ABC, CBS, FOX, and NBC) and their affiliated studios produced from 76 to 86 percent of prime-time programming hours in 2002, 2005, 2008, and 2009, with the remaining hours coming from independent producers.[10] FCC similarly reported that the production studios of major media and entertainment companies, which also hold broadcast and cable networks, often create and license television programs and movies. This pattern does not hold for all companies. For example, Discovery Communications does not own a major television or movie studio and Sony Corporation, another large media and entertainment company, operates a television and movie studio, but does not operate a broadcast or cable network.

The concentration of content production among a handful of large media and entertainment companies has changed little in recent years. We compared the ownership of major broadcast and cable networks from 2005 through 2012, and found little change in the pattern of ownership

[10]GAO, *Media Programming: Factors Influencing the Availability of Independent Programming in Television and Programming Decisions in Radio*, GAO-10-369 (Washington, D.C.: Mar. 17, 2010).

and concentration of production. For example, of the top 20 cable networks by subscribership in 2005, more than half experienced no change in ownership from 2005 through 2012. However, some ownership change did occur during this period. In 2005, the former Viacom split into two companies—CBS and Viacom.[11] In 2009, the Time Warner Cable distribution business was spun off from the Time Warner Inc. content business. Lastly, Comcast, the largest distribution company in the United States, merged with NBCUniversal;[12] this transaction added NBCUniversal's content and networks to Comcast's existing, more limited media holdings, which include the Golf Channel and E! Entertainment.

Since 2005, Some Local Markets Have Gained Access to Additional MVPD Service

Since 2005, the introduction of telephone-based video service has brought additional MVPD competition to some areas. Traditional telephone companies AT&T and Verizon—through their respective U-verse and FiOS products—have led this change, introducing video services in various areas across the country and competing with cable and satellite companies.[13] Verizon first introduced its FiOS TV service in 2005 and as of year-end 2012, reported having 4.7 million subscribers with service available to 17.6 million households. As of year-end 2012, AT&T's U-verse service had 4.5 million subscribers with service available to more than 24.5 million households. In addition to AT&T and Verizon, other competition has emerged in a limited number of areas. For example, Google introduced Google Fiber in the Kansas City metropolitan area. Like cable companies, AT&T, and Verizon, Google Fiber includes broadband Internet and television service.[14] Google Fiber is a pilot

[11]The Executive Chairman of the Board for Viacom and CBS remains the same individual.

[12]Comcast acquired control of NBCUniversal in a $13 billion transaction. In January 2011, Comcast and NBCUniversal's parent General Electric (GE) entered into a joint venture in which Comcast held a 51 percent share of the company. FCC and DOJ approved the merger on January 18, 2011, subject to a range of conditions intended to protect competition. In March 2013, Comcast completed its acquisition of the remaining 49 percent stake in NBCUniversal held by GE. This transaction represented a form of vertical integration, where the principally downstream distributor (Comcast) acquired control of a company with significant upstream content development and aggregation holdings (NBCUniversal).

[13]AT&T and Verizon provide many of the same cable channels that cable and satellite MVPDs provide.

[14]Google reports that its television service includes 20 local stations and 152 cable channels.

project, and it is unknown to what extent Google will expand its deployment to other cities; although, in April 2013, Google announced that it would introduce Google Fiber in Austin, Texas, and Provo, Utah. In addition, we have previously reported that the Universal Service Fund managed by FCC, which provides subsidies to telephone companies that serve rural and other remote areas with high costs, enables some companies to upgrade their telephone networks, including upgrading to fiber optic cable and extending it closer to their customers.[15] The upgraded networks enable these companies to provide video and broadband service in some rural and remote areas.

With the new entry in some areas, roughly 1 in 3 households had access to at least 4 MVPDs at year-end 2010.[16] As a result, the nationwide market shares have shifted among MVPDs since 2005 (see fig. 2). In particular, cable companies have seen their nationwide market share drop, continuing a longer-term decline. For example, NCTA estimated that cable companies' share of MVPD subscribers has dropped from 98 percent in 1992 to 57 percent in 2012. Satellite services have continued to grow, although more slowly in recent years. Financial analysts and other experts report that satellite companies could face increasing competitive challenges from cable and telephone companies going forward. In particular, as consumers increasingly purchase a bundle of video, broadband Internet, and telephone services, satellite's slower Internet service could dissuade consumers from purchasing satellite service.[17] For example, DirecTV reported that various telephone and broadband companies also sell its service as part of a bundle with their voice and data services, and these companies could focus less effort and resources selling DirecTV's service or decline to sell it at all as they

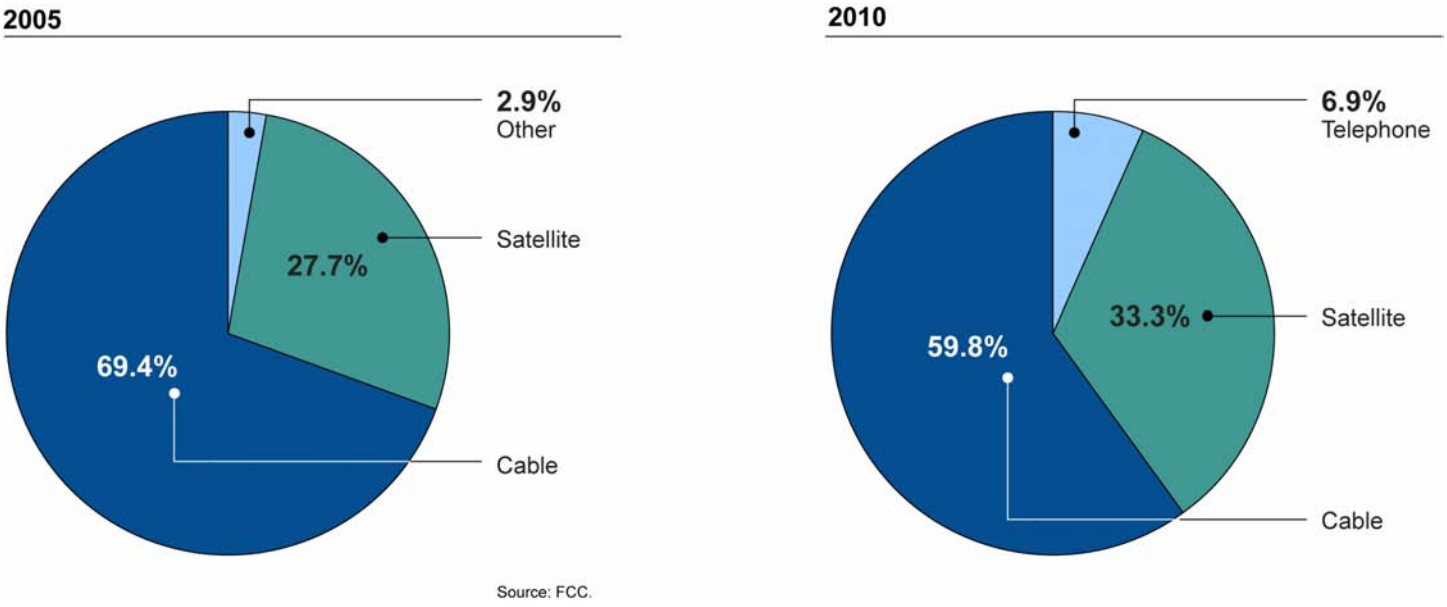
[15]GAO, *Telecommunications: FCC Has Reformed the High-Cost Program, but Oversight and Management Could be Improved*, GAO-12-738 (Washington, D.C.: July 25, 2012) and *Telecommunications: FCC Needs to Improve Performance Management and Strengthen Oversight of the High-Cost Program*, GAO-08-633 (Washington, D.C.: June 13 2008).

[16]Two of these MVPD choices are satellite providers (DirecTV and Dish Network), which offer national video services to consumers and local television stations in many markets. For purposes of its analysis, FCC assumed that satellite was available to all households. 27 FCC Rcd. 8610, 8626 (2012).

[17]We discuss the MVPDs' bundled services more fully in the next section.

deploy networks with the capability of providing video, voice, and data services.[18]

Figure 2: Multichannel Video Programming Distributors' Subscriber Market Share in 2005 and 2010



Source: FCC.

Note: For 2005, FCC did not include a category for telephone.

Although more households have access to at least 4 MVPDs than in the past, roughly 2 in 3 households still had access to 3 or fewer MVPDs at year-end 2010, 2 of which were the satellite providers. While the entry of telephone companies into the video marketplace offers some households more options, representatives from AT&T and Verizon were uncertain about the scope of future expansion. AT&T announced that the company will expand its U-verse service to be available to 33 million households—an increase from 24.5 million—but the company may also discontinue service to other areas simultaneously. Verizon officials reported that the company has no current plans to expand FiOS beyond its goal of making service available to 18 million households. In addition, according to FCC, at year-end 2010, about 1.5 percent of households had access to just 2 MVPDs, which are the two major satellite companies. In our analysis of

[18]DIRECTV, Form 10-K (Annual Report), filed Feb. 21, 2013.

MVPD service in 20 zip codes, one zip code—encompassing Limon, Colorado—was not served by a cable company and relied solely on satellite service.

Online Video Products Have Emerged as a New Form of Video Distribution

Technological advances increasingly enable distribution of video online. Internet speeds have increased as companies deploy new, high-speed technologies, such as fiber optic cable, to the neighborhood or the residence. These new technologies enable many U.S. households to *stream video*—that is, access and view video content via online sources. Watching video online generally requires an Internet connection with a speed of .7 to 4 megabits per second, depending on the quality of the video;[19] for example, high-definition video requires higher Internet speeds than standard definition video. In August 2012, FCC reported that over 40 percent of U.S. households had adopted broadband speeds of at least 3 megabits per second.[20]

A variety of business models supporting online video have emerged; some online video is available free, while other content is available with payment.[21] Online sites such as YouTube aggregate user-created and other content and make this content available to viewers free with an Internet connection. Increasingly, professional content is appearing on YouTube. For example, ABC News has segments from ABC World News and Good Morning America available on YouTube. Other services, such as Netflix and Amazon Prime Instant Video, entail one-time or monthly rental fees to access content, including television programs and movies. Still other models exist, where content owners sell their content directly to consumers. In particular, Hulu—a joint venture that includes News Corporation, NBCUniversal, and Disney—offers a free advertiser-supported service and a monthly subscription service with fewer commercials and access on a wide variety of devices.

[19]Megabits per second refers to how fast information can either be uploaded to or downloaded from the Internet. Higher speeds enable consumers to receive information much faster and thus enable certain applications to be used and content to be accessed that might not be possible with a slower connection, such as viewing video content.

[20]*Eighth Broadband Progress Report,* GN Docket No. 11-121, Eighth Report, 27 FCC 12-90 (2012). The data in this report are from 2011, and the percent of households with broadband service may have increased since that time.

[21]Online sites with content available for free, as well as those sites that require payment, may also have advertising present.

While the Internet has emerged as a new source for viewing video, online viewing and revenues represents a small portion of overall media activity, particularly as compared to traditional television. In September 2012, Nielsen reported that 162 million Americans watched online video, consuming on average nearly 7 hours of content over that month.[22] In contrast, Americans watch over 34 hours of live television per week. Additionally, several financial analysts and experts whom we interviewed described Internet advertising as still in its infancy, with viewership and advertising still developing and companies exploring successful business models. For example, FCC, citing data from Investor's Business Daily, reported that in 2009 advertisers spent $908 million on U.S. online video advertising compared to $68.9 billion spent on U.S. television advertising during that same period.

Consumers Continue to Acquire Programming and Content through Packages, but Online Video Providers Are Delivering New Choices

MVPDs Generally Provide Large Packages of Channels

In general, MVPDs provide video content by packaging together a large number of channels in different programming tiers—often the basic, expanded basic, and premium tiers. In our analysis of MVPD services in 20 zip codes in 2013, all MVPDs reported requiring consumers to purchase tiered packages of channels. We found that the basic tier of these MVPDs consisted of a minimum of 13 channels, with local broadcast and informational channels sometimes dominating this tier; the price of the basic tier ranged from $9.95 to $40 per month.[23] The

[22]Nielsen collects and reports on media information, including television program ratings.

[23]These and other tier prices are the rates charged to new customers. Higher rates may apply after a set period of time.

expanded basic tier usually included the channels in the basic tier and additional cable networks, such as ESPN, Nickelodeon, USA Network, MTV, and A&E. Higher end, premium tiers usually included more than 100 channels and the monthly subscription price for this tier ranged from $53 to $200.49. In all 20 zip codes we analyzed, the MVPD included HBO, Showtime, and Cinemax in its premium tier. Because subscribers must receive all of the channels offered on a tier that they choose to purchase, they have little choice regarding the individual channels that they receive. À la carte service—where consumers purchase content on a channel-by-channel basis—is generally not provided by MVPDs. None of the MVPDs we interviewed, or any MVPDs included in our analysis of 20 zip codes, provided à la carte service; the only exceptions were premium channels and pay-per view services, which were often available on a stand-alone basis.[24] For example, HBO was available for an additional $6.00 to $26.95 per month in the 20 zip codes we analyzed.

Contractual and economic factors lead MVPDs to package channels into tiers rather than providing à la carte service. Contractually, content companies generally seek to have their networks carried on the largest tier, typically the expanded basic tier. These companies have an economic incentive to pursue this strategy; content providers typically receive both a monthly fee for each customer that subscribes to the tier on which their network appears and advertising revenues, which are based in part on the number of potential viewers (e.g., subscribers) to the tier on which their network appears. Content companies and others reported that they might need to charge more for certain content under an à la carte system because of potential revenue losses and that the price of a single channel could be significantly higher with an à la carte system compared to the current tiered system. Consumer groups expressed concerns that à la carte service could diminish diversity and local aspects of existing programming if lower demand networks cease operation because of a lack of subscribers. Some experts with whom we spoke also questioned whether consumers would necessarily be better off with à la carte pricing of channels, given the potential for reduced quantity and quality, and higher prices for individual channels.

[24]To acquire a premium or pay-per-view service, the consumer must still purchase a lower-level tier.

Some MVPDs are providing increased service options to consumers. For example, some MVPDs are making content available through TV Everywhere services. These services allow MVPD subscribers to view some content on mobile devices, typically smartphones or tablet computers, and from various locations within and, depending on the service, outside the residence. Some MVPDs charge for these additional features as a stand-alone service or include them as part of a digital package, and some require that the customer subscribe to both the company's MVPD and broadband services. In addition, some MVPDs are bundling telephone, Internet, and video services. These bundles have a higher aggregate price, but the consumer's total cost can be less than if the consumer purchased these services separately. For example, one MVPD included in our zip code analysis provided a tier of channels for $39.95, Internet service for $39.95 per month, and telephone service for $34.95 per month. Alternately, a consumer could receive these three services in a bundle for a monthly price of $84.95, a savings of $29.90. Such bundling appears to be widespread; of the 20 zip codes in our analysis, consumers in all 20 had access to one or more bundles. FCC reported that as the number of video subscribers has fallen, cable companies have prospered by increasing sales of other services, such as phone and Internet access, to their remaining customers.[25]

New Entrants Are Providing Increased Choices

OVDs and related companies provide consumers with increased flexibility in selecting content. Services like Hulu and Netflix allow consumers to select content based on a program, or even an episode basis. Some experts and consumer groups with whom we spoke said that these new online options constituted a *programmatic à la carte*, rendering debates over whether or not consumers should have the ability to purchase specific channels less relevant. OVDs' libraries are limited, however, and OVDs do not have the rights to display certain television programs and movies. To maximize the return on investment from producing video content, where costs can be quite high, content owners generally distribute content through a series of outlets over time, through a process known as *windowing*. Content is distributed in the most lucrative outlets first, and depending on the type of content, the windowing process can take months or years to fully play out. Distribution of content through an OVD is often last in the series of outlets, as content providers first

[25]27 FCC Rcd. 8610 (2012).

distribute television programs through broadcast or cable networks and feature films through movie theatres. Because of this, OVDs typically are not able to obtain first run television programs and movies; for example, a television program may have to finish its entire season before a single episode becomes available online. Thus, although the same content is available in earlier windows through other outlets, windowing can limit the value of OVDs' services for some consumers. As such, most of the industry representatives and experts with whom we spoke stated that, at this time, OVD services are generally seen as a complement to MVPD services, rather than a substitute.

Nonetheless, some content companies are providing content directly to consumers online. Sports leagues are one such example. Major League Baseball provides its MLB.TV service, where subscribers can watch baseball games live online or at a later time, as well as recaps and other baseball news. The National Basketball Association provides a League Pass service where subscribers can watch some games live, have access to live game statistics, and review an archive of content for the season. In addition, other content aggregators, like cable networks, have made content available online. For example, AMC has an online service where viewers can watch shows such as Mad Men. In another example, HBO has an online version of its network, HBOGO, where viewers can watch all of the movies and other content on this premium network.[26] Much of this and other online content can also be accessed through electronic portable devices. Indeed, some of the aforementioned sport content services provide mobile options for subscribers.

Consumers incur costs to acquire these online video services. First, a consumer must purchase a broadband Internet connection to view video content online. The price for Internet services provided by MVPDs in the zip codes we analyzed ranged from $19.99 to $69.99 per month.[27] Once connected, some online content is available at no charge on sites such as YouTube. Other content is available on a pay-per-view or rental basis. For example, Amazon's Prime Instant Video service includes a rental

[26]Authentication of existing subscription to cable and premium networks is required to access this content online.

[27]These prices are for a basic Internet connection; some MVPDs provide higher-speed options for a higher price. These prices also do not include satellite companies, which do not provide a stand-alone Internet service.

option where a consumer can pay a set amount (usually $1.99 to $4.99) to view a movie in a 30-day window. Services like Netflix are subscription-based with recurring, monthly fees for continued access to their content library.[28] Content viewed directly from content companies also generally requires a monthly or yearly fee. For example, the price for Major League Baseball's MLB.TV services is $94.99 for a year or $19.99 per month.

Prices for Traditional MVPD Services Continue to Increase

Despite entrants providing new choices, the price of MVPD video service continues to increase. In its most recent annual report on cable rates, FCC reported that over the course of 2010, cable rates rose 5.4 percent.[29] From 2005 through 2011, cable rates rose more than 33.5 percent for both basic and expanded service tiers (see table 1). This increase outpaced inflation captured in the Consumer Price Index, which rose 15.5 percent over the same period. Besides cable service, other MVPDs' prices have increased faster than inflation. For example, in January 2013, Dish Network raised the price for its services between 7 to 20 percent; this included a price increase of $5 for its basic service package—from $24.99 to $29.99 per month. DirecTV also increased its prices in February 2013, raising its average price by 4.5 percent.

Table 1: Cable Rates—2005 through 2011

Year	Basic service price	Expanded basic service price	Consumer price index
2005	$14.30	$43.04	126.90
2006	$14.59	$45.26	131.90
2007	$15.33	$47.27	134.70
2008	$16.11	$49.65	140.40
2009	$17.65	$52.37	140.50
2010	$17.93	$54.44	144.20
2011	$19.33	$57.46	146.50
Percentage Increase	35.2%	33.5%	15.5%

Source: GAO analysis of FCC Report on Cable Industry Prices, August 13, 2012.

[28]The price of Netflix's online subscription service is $7.99.

[29]This reflects the average rate for expanded basic service, the most popular tier among consumers, from a sample of cable and telephone companies. This does not include MVPD operators of wireless systems, satellite companies, or AT&T U-verse.

Representatives from MVPDs and content companies, consumer groups, and other stakeholders identified a variety of causes for continued rate increases. MVPD and content companies cited the cost of content production as one factor. The cost of acquiring "must have" content—content that is very much in demand by consumers, such as live sports—has become increasingly expensive. Sport leagues, such as the National Football League and Major League Baseball, are seeking higher fees from broadcast and cable networks to carry their sporting events. For example, in its latest contract with ESPN, Major League Baseball will receive approximately $5.6 billion for the years 2014 through 2021; this represents a 100 percent increase above the previous agreement. Broadcast and cable networks may in turn pass along these higher prices to MVPDs, which ultimately contribute to higher consumer prices for MVPD service. Infrastructure investment costs, such as cable companies continuing to roll out broadband Internet service to new communities and locations, may also play a role. For example, NCTA reported that the cable industry's capital expenditures for 2011 were $12.9 billion.

Although Technology Will Likely Continue to Spur New Services and Products, a Variety of Factors May Hinder Future Competition in the Video Marketplace

Technological Advances and Increased Spectrum for Wireless Services Could Spur New Services, Products, and Competition

Advances in digital technologies and increased Internet capacity could help lower the cost to develop and distribute some video content. Some high-quality digital video cameras and editing equipment can be purchased for less than a thousand dollars, enabling individuals and small startups to create content at relatively low cost. As a result, individuals and startups can produce web series of low-budget programs and develop dedicated online channels to carry content. In addition, *crowdfunding*—the practice of funding a project or venture by raising small amounts of money from a large number of people, often online—provides a mechanism for startups to acquire the financial resources to develop content. Furthermore, technological advances can lower the

costs to distribute content through online platforms like YouTube, which provides free content posting. OVDs can distribute content online at relatively lower costs than traditional MVPDs, which own physical networks and tend to distribute more costly professionally produced movies, sports, and television programs. For example, whereas OVDs have limited distribution costs as consumers pay subscription fees to access the Internet and online video, traditional MVPDs built, operate, and maintain the networks through which Internet bandwidth and online video is provided.

Increased spectrum for wireless broadband could facilitate greater distribution and viewing of video content wirelessly. According to industry stakeholders and experts with whom we spoke, today's terrestrial wireless networks are unable to support widespread, large-scale viewing of video content; these networks' capacities are much less than existing wired and satellite networks deployed by cable, telephone, and satellite companies. However, increased spectrum for wireless broadband, combined with compression technologies that allow more efficient use of spectrum, could allow for additional viewing of video content wirelessly. According to FCC, the Commission's 2008 auction of spectrum licenses resulted in some mobile wireless service providers beginning to offer mobile broadband services for laptop computers, tablets, smartphones, and other mobile devices. FCC is planning another spectrum auction for wireless services in 2014. According to industry stakeholders and experts with whom we spoke, more spectrum for wireless services could spur additional competition, with more companies entering the marketplace to provide online video services accessible via smartphones and tablets. However, as we have previously reported, most spectrum has already been allocated and assigned to other users, including federal agencies such as the Department of Defense, and reallocating spectrum from other uses can be time-consuming, costly, and contentious.[30]

[30]GAO, *Spectrum Management: Incentives, Opportunities, and Testing Needed to Enhance Spectrum Sharing*, GAO-13-7 (Washington, D.C.: Nov. 14, 2012).

A Variety of Factors May Hinder Future Competition

Availability and Licensing of Professionally Produced Content

The high costs to license professionally produced content could hinder the competiveness of entrants and small distributors. Some professionally produced and time-sensitive programming, like sports and popular prime time shows, are highly valued by many viewers. As the supply of those who are involved in the production of such popular programming—well regarded athletes, writers, actors, and directors—is limited, their talents command premium compensation, often in the millions of dollars. While large MVPDs that have subscription and advertising revenues can pay the license fees for this content, smaller MVPDs and new OVDs that are not as established in the marketplace may not be able or willing to do so.

In addition, OVDs told us that competition could be hindered by the fact that content providers will license their content to them, but only on similar contractual prices and terms that they offer to traditional MVPDs. In particular, OVDs told us that licensing contracts have "most-favored nation" (MFN) clauses that guarantee a customer will receive prices and terms that are at least as favorable as those provided to other customers of the same seller. Because of MFN clauses, OVDs assert that content providers will not enter into agreements with OVDs that are different from agreements that they have with MVPDs. As a result, OVDs said that MFN clauses inhibit their ability to compete, as they cannot offer consumers different programming choices and prices than MVPDs, thus making it difficult to attract customers. DOJ and the Federal Trade Commission (FTC), which investigate certain proposed mergers and potential antitrust violations, jointly sponsored a workshop in September 2012 on MFN clauses and their benefits and risks to competition.[31] According to DOJ's press release announcing the workshop, MFN clauses, though at times employed for benign purposes, can under certain circumstances present competitive concerns. DOJ noted that MFN clauses might, especially when used by a dominant buyer of intermediate goods, raise other buyers' costs or foreclose would-be competitors from accessing the market. While high prices and contracting terms could hinder entry, some

[31]See Department of Justice, Federal Trade Commission to Hold Workshop on Most-Favored Nation Clauses (Aug. 17, 2012), accessed June 5, 2013, at http://www.justice.gov/atr/public/press_releases/2012/286144.htm. Although no panel focused specifically on the use of MFNs in the video marketplace, the panelists' discussion of MFNs in general may be illuminating with respect to the video industry as well.

larger OVDs with subscription services have taken steps to overcome these challenges. For example, Netflix signed a multiyear billion-dollar agreement with Disney Corporation to license its content beginning in 2016. In addition, some OVDs have begun producing their own original content. For example, Netflix created its first original series, House of Cards, which debuted on February 1, 2013, and Amazon currently has 12 pilots in development that will be available on its Prime Instant Video service.

Entry into the Traditional MVPD Market

Based on our discussions with an array of industry stakeholders and experts, the prospect of any new wire-based providers entering the video market appears unlikely. As previously discussed, the two telephone providers that expanded their service offerings to compete with incumbent cable companies—AT&T and Verizon—appear to be curtailing further expansion of their video and broadband Internet services. Both companies made very large investments to upgrade their networks—an expected $23 billion in the case of Verizon and billions of dollars, according to AT&T—to provide new video and broadband services, despite the fact that the companies were established telephone companies with existing telecommunications infrastructure in place. The high costs to provide these services create a substantial barrier to entry.[32] In particular, not only are the overall costs of entry into the video distribution market high, but many of these costs are fixed, meaning that much of the infrastructure needs to be in place before the provider can initiate service. High fixed costs can render entry difficult because an established company with a large customer base will generally enjoy a significant cost advantage over a new entrant.

The costs involved in entering the video distribution market fall into several categories including: (1) physical infrastructure, (2) regulatory authorizations, (3) securing access to broadcast and cable programming, and (4) marketing.

Physical infrastructure for providing video. Providing wire-based video service requires an extensive physical network. The provider needs to be

[32]In addition to wire-based providers, the entry of a satellite company appears unlikely. Deploying a network of satellites and ground stations is costly, and there are a limited number of available slots in orbit to locate a satellite. See, GAO, *Telecommunications: Competition, Capacity, and Costs in the Fixed Satellite Services Industry*, GAO-11-777 (Washington, D.C.: Sept. 7, 2011).

able to capture video signals from various sources—broadcast transmitters, fiber optic cable, satellites—each source requiring specific communications infrastructure. Once captured at the provider's facilities, video signals are transported to households. Transmission requires a wired network from the provider's facility travelling across highways and byways, into neighborhoods, and ultimately linked to every subscribing household. Installation of such a network is expensive: the provider generally needs to dig trenches along roads and into neighborhoods in order to install equipment and wire. This fairly extensive and expensive network of communications reception and transmission equipment needs to be in place before any service can be provided, so much of the video capture infrastructure, trench digging, and wire installation costs are fixed.

Regulatory authorizations and coordination with private party facilities owners. A new provider must work with local jurisdictions to obtain authorizations to undertake various activities. Cable providers are required to obtain a franchise authorization for each jurisdiction they serve. Franchise areas vary in size, but they typically cover a town or relatively small jurisdiction, so gaining franchise authorization to enter any significant geographic area can be time-consuming.[33] In addition, to deploy cable for the network, a provider requires access to public rights-of-way. The governmental entities that grant franchises and access to rights-of ways vary by state, which again may mean that an entrant needs to obtain a grant to access rights-of-ways from multiple jurisdictions.[34] Once the grant is received, a video provider must work with either the local telephone or utility companies to undertake the necessary installation work, because these companies generally are the owners of the poles or conduits over or through which wires are deployed along the rights-of-way. As with the physical installation, obtaining regulatory authorizations and coordinating installations generally needs to take place before the provider can begin to service customers.

[33]Like traditional cable companies, Verizon chose to secure franchises from the relevant jurisdictions where it introduced FiOS service. In contrast, AT&T asserted that its U-verse service is not subject to local franchise regulation as a traditional cable television service, but is generally authorized by statewide franchises.

[34]According to FCC, historically states vested franchise authority primarily in either county or municipal governments; however, approximately 20 states now have statewide video franchising.

Acquisition of Programming. A new provider in the video market needs to secure access to a large portfolio of broadcast and cable networks to compete for customers. The cost of the programming itself is paid monthly based on the number of subscribers the provider serves, and according to providers with whom we spoke, prices for programming are high and continue to increase. Several of the providers and experts with whom we spoke also told us that networks generally offer significant discounts based on the number of subscribers a provider has. Thus, a substantial disadvantage that an entrant has relative to a large provider is that it will likely have higher programming costs, making entry challenging.

Marketing. A new entrant needs to make the public aware of the new services it is offering and attempt to convince potential customers to buy its services. This can pose many challenges for an entrant. As mentioned earlier, over 85 percent of households already subscribe to a video service, so most potential customers are already buying a service. Thus, most customers need to be persuaded to switch their provider. Additionally, many households buy a bundle of services from their provider—video, broadband Internet, and sometimes telephone—and the inconvenience of switching over several services to a new provider is greater than it might be for a stand-alone service. Such challenges that an entrant would face to gain subscribers can also act as a barrier to entry.

Online Entry and Business Practices of Established Industry Sectors

While OVDs present a new and exciting venue through which consumers can enjoy video services, we found that OVDs do not yet offer a package of programming that is substantial enough to induce households to drop their subscription to a traditional video service in favor of an OVD's services. OVD providers have a variety of business models, but fundamentally, they are dependent on two established industries—developers of video content and providers of broadband Internet access—and this dependence could hinder any significant maturation of the OVD business model.

Content. OVDs purchase content from the same content providers as do traditional MVPDs, and content providers and MVPDs have long-standing and lucrative business relationships. As discussed above, high-valued content, such as professionally produced movies and television programs, is costly to produce. Therefore, even if some OVDs are successful in developing some independent content, they will remain largely dependent on traditional sources of content. Content providers enjoy a stable and secure business model distributing programs on

MVPD systems. In particular, content providers benefit from MVPDs packaging many channels because it ensures that most households purchase a large set of channels.[35] Similarly, MVPDs benefit from their purchase of high-quality content, which most households value enough to induce them to purchase a large tier of MVPD programming.[36] Thus, there is a symbiotic benefit in the business relationship between the content producers and MVPDs.

At the same time, content providers are also interested in selling their programs to OVDs. In particular, representatives of several such companies, as well as experts, said that through these new outlets, content providers are able to monetize their products in new ways. For example, OVDs can distribute content separate from the bundles of content offered by broadcast and cable networks, which may have a unique commercial appeal and attract new consumers to content providers' programs. However, content providers are also wary about the extent to which they contract for OVD distribution of their programs. If OVD offerings become attractive enough that households begin to drop MVPD subscriptions and rely solely on online viewing, revenues earned through traditional subscription service will decline, affecting both content providers and MVPDs. The issue is the extent to which this happens: the impact of a small number of households doing so may not be of concern to content providers, but if a substantial number of households choose to "cut the cord," revenues of both the content providers and the MVPDs could be reduced enough to be worrisome for these companies. Thus, while content providers are interested in providing some content to OVDs, their incentive to do so is somewhat constrained by the potential effect on subscriptions to traditional MVPDs. Some stakeholders with whom we spoke stated that the critical challenge for the OVD business model is access to quality content and that as long as content providers do not see

[35]A consumer will purchase a large package of channels, even if the consumer only watches a few channels, if the consumer's willingness to pay for those channels is at least equal to the price of the entire package.

[36]In February 2013, Cablevision, the ninth largest MVPD based on subscribers, filed an antitrust suit against Viacom. In a statement, Cablevision said that Viacom effectively forces Cablevision's customers to pay for and receive little-watched channels in order to get the channels they actually want. See, Cablevision Systems Corporation, et al. v. Viacom International Inc, et al., U.S. District Court, Southern District of New York, 13-1278.

OVDs as a viable outlet for the highest quality content, the growth of the OVD business model will be limited.

Broadband. Most households with broadband purchase that service from either a cable or a telephone company.[37] Thus, the companies that provide a large portion of the broadband access in the country are the same companies that OVDs are attempting to compete against in the video marketplace. Users who view video provided by OVDs are often large consumers of broadband bandwidth, and heavy use may place stress on the broadband infrastructure. Some MVPDs have created pricing structures for bandwidth that, in one manner or another, extract higher fees from heavy users. OVDs and other experts have expressed concern that, because MVPD providers are also competitors of OVDs in the video market, MVPDs may have an incentive to charge for bandwidth in such a way as to raise the costs to consumers for using OVD service. Some of the industry groups and experts with whom we spoke stated that some form of usage-based pricing was probably inevitable and reasonable based on the costs of maintaining the infrastructure, but that they would be concerned if such pricing was used in any way that could stall the growth of the nascent OVD market. For example, they would be concerned if there were any differential treatment of broadband use for accessing the content of the MVPD versus that of OVD providers.

[37]The primary companies providing broadband service are cable and telephone companies. Cable companies provide broadband service using their fiber-coaxial network. Telephone companies provide broadband service using either fiber optic cable or digital subscriber line (DSL) technology, although DSL is generally slower than fiber-coaxial or fiber optic technology. Satellite companies can also provide broadband service, but like DSL, it is generally slower than fiber-coaxial and fiber optic technologies.

Stakeholders Generally Noted That Laws and Regulations Have Not Kept Pace with Changes, and FCC Has Not Consistently Reported on Competition

The Majority of Stakeholders Noted that Some Laws and Regulations Are Out of Date, but Little Agreement Exists on Potential Changes

The 1992 Act was written over 20 years ago, and for a variety of reasons, the majority of stakeholders with whom we spoke stated that some provisions of the laws and associated regulations do not reflect the current marketplace. Stakeholders told us that there have been significant changes in competition in the video marketplace since 1992. For example, cable companies were often the only choice of a video distributor for most consumers in 1992. Since then, satellite and telephone companies have entered the marketplace, and consumers have more choices in selecting a video distributor. In addition, the 1992 Act was written before the commercialization of the Internet and other technological advances, such as tablets and smartphones, which allow for online video and wireless distribution. As previously discussed, online video viewing is a small portion of overall viewership. However, experts with whom we spoke said that the trend is for growth of online video with the expansion of WiFi and 4G infrastructure and the greater use of tablets and smartphones. Furthermore, since 1992, MVPDs have digitalized their systems and the number of channels carried on these systems has risen dramatically, an increase that has led to more content being developed and more content options available for consumers. Due to these marketplace changes, the majority of stakeholders we interviewed stated that some provisions in the 1992 Act should be revisited; however, other stakeholders disagreed, stating that given the quickly developing, dynamic, and technology-oriented nature of the industry, it is difficult for laws to keep up with changes. These stakeholders noted that, as was the case in 1992, it is hard to predict what the marketplace will be like in the future and therefore difficult to envision appropriate laws and regulations.

Most of the stakeholders who told us that some provisions of the 1992 Act should be revisited had varying opinions, which were often based on their position in the marketplace. In general, stakeholders identified three

issues related to the 1992 Act that they believe should be addressed: (1) retransmission consent, (2) program access, and (3) the definition of MVPD and OVD. In addition, stakeholders also had varying opinions on FCC's Open Internet regulation.

Retransmission Consent. One of the concerns expressed by stakeholders and experts with whom we spoke was the manner in which retransmission consent is functioning in the market today. Policies to support localism have long been a focus of communications laws related to television broadcasting. In 1992, Congress took action to help ensure that the local benefits of over-the-air broadcast television stations were protected as more households began to migrate to pay video services over cable systems. The 1992 Act thus set forth a paradigm under which commercial, local television stations[38] can choose to be carried by cable companies under a *must carry* status—meaning that cable companies in their market are obliged to carry the station's signal—or can elect to negotiate for carriage under *retransmission consent*.[39] The purpose behind the dual policies of must carry and retransmission consent was, in part, to support the development of local news, emergency weather information, and other local public interest content. While a must carry station does not receive any compensation for the carriage of its signal, a station electing retransmission consent can negotiate with cable companies for compensation in return for the cable company's right to carry the station's signal. Thus, must carry provisions were designed to ensure that all local commercial stations would be carried by cable companies, which may not have occurred for some stations that do not have a significant commercial appeal. At the same time, retransmission consent was designed to ensure that stations choosing this status had the ability to bargain for compensation for the value of their local television signal.

During roughly the first decade after the 1992 Act was passed, negotiations for retransmission consent usually did not result in cash payments from cable companies to local television stations, but rather,

[38]Noncommercial television broadcast stations, mostly public television stations, have must carry rights but do not have the option of electing retransmission consent.

[39]Satellite companies may choose to carry local broadcast stations. In television markets where they do so, all local broadcast stations are entitled carriage ("carry one, carry all") and commercial stations may elect whether they want to be carried under similar must carry and retransmission consent provisions as are applied to cable systems.

resulted in other forms of negotiated compensation, such as carriage of fledgling cable networks owned by broadcast networks. But over the last several years, negotiated cash fees for retransmission have increased significantly, as we reported in 2011.[40] Stakeholders with whom we spoke—specifically cable and DBS companies, as well as industry experts—told us that the rapid rise in retransmission fees is of concern because these fees put upward pressure on subscriber rates, and the negotiation over fees have become increasingly contentious, leading to more "blackouts" during which local television signals are pulled from a particular MVPD's channel lineup.[41] Moreover, some of those concerned about increasing retransmission fees noted that while the concept underlying retransmission consent was to support local television stations, they believe that a portion of the financial compensation paid through retransmission fees is, in fact, not going to local television stations. Instead, critics told us that a good portion of retransmission fees are flowing to the broadcast networks that own or have affiliation agreements with the local stations and that ultimately a portion of these fees flow to the copyright holders of high-valued content purchased by broadcasters, such as sports leagues and studios producing popular dramatic TV series.

Others with whom we spoke—from broadcast networks and an associated trade association—told us that retransmission consent remains an important foundation for developing programming. They noted that without this form of compensation, broadcasters would not be able to continue to provide high quality programming and emergency local

[40]GAO, *Statutory Copyright Licensing: Implications of a Phaseout on Access to Television Programming and Consumer Prices Are Unclear*, GAO-12-75 (Washington, D.C.: Nov. 23, 2011).

[41]Aereo has developed a business model that may challenge the functioning of retransmission in the marketplace. The company has begun providing local broadcast stations to subscribers of its service by capturing broadcast signals at its facilities with an antenna dedicated to each of its subscribers and then transmitting that signal via an Internet Protocol (IP) network to its subscribers' residences. This has allowed Aereo to develop a unique video product that bypasses the retransmission consent fees that are paid by cable and DBS companies for providing broadcast signals to their subscribers. However, broadcast networks view Aereo's activities as violating copyright law, and the issue is currently in litigation. In April 2013, the U.S. Court of Appeals for the Second Circuit upheld a lower court's denial of WNET's motion for a preliminary injunction, finding that Aereo was unlikely to be liable for copyright infringement. *WNET v. Aereo, Inc.*, 712 F.3d 676 (2nd Cir. 2013). On April 15, 2013, the plaintiffs filed a petition for reconsideration *en banc,* that is, by the full membership of the court.

information. These stakeholders also said that broadcast stations have the right to control their television signal and that any attempt to alter this long-standing policy would be harmful to the television broadcasting system that was developed decades ago.

Program Access Rules. The 1992 Act gave FCC the authority to establish program access rules that require cable companies that produce content to make that content available to other unaffiliated MVPDs. Cable companies say these rules are no longer needed because they do not have monopoly power and that other MVPDs have access to content. Cable companies also note that it is their First Amendment right to determine to whom they license their content. However, OVDs, consumer groups, and experts state that the program access rules need to be continued and extended to include OVDs, whom they say have difficulty accessing content. As noted earlier, limited access to high-valued programming is one of the factors that stakeholders told us could hinder competition. Stakeholders told us that the program access rules allowed satellite and telephone companies to compete and grow and that new entrants, such as OVDs, should have the same protections. In October 2012, FCC declined to extend the exclusive contract prohibition, originally enacted as part of the program access statutory provisions, beyond its scheduled sunset date. FCC stated that a preemptive prohibition on exclusive contracts was no longer necessary because a case-by-case process under the program access rules would remain in place after the prohibition expired to assess the impact of individual exclusive contracts.[42] FCC has received program access complaints, including one from an OVD—Sky Angel—in March 2010.[43] Sky Angel also filed lawsuits against Discovery Communications and the National Cable Satellite Corporation, the owner of cable channel C-SPAN, to access programming from these two companies.

[42]In the Matter of Revision of the Commission's Program Access Rules. 27 FCC Rcd 12605 (2012).

[43]*See* Sky Angel U.S., LLC v. Discovery Communications LLC, *et al*., Program Access Complaint, MB Docket No. 12-80, File No. CSR-8605-P (Mar. 24, 2010) ("Sky Angel Complaint"); Sky Angel U.S., LLC v. Discovery Communications LLC, *et al*., Emergency Petition for Temporary Standstill, MB Docket No. 12-80, File No. CSR-8605-P (Mar. 24, 2010) ("Sky Angel Petition"); *see also* Sky Angel U.S., LLC v. Discovery Communications LLC, *et al*., Renewed Petition for Temporary Standstill, MB Docket No. 12-80, File No. CSR-8605-P (May 27, 2011).

Definition of MVPD. As defined in the Communications Act, an MVPD is, among others, a cable operator or satellite provider that makes available for purchase multiple channels of video programming.[44] Experts with whom we spoke said that OVDs generally have not been regarded as MVPDs because OVDs are not facilities-based, in that they do not own the Internet bandwidth through which their content is distributed. FCC staff has determined that Sky Angel—an OVD that offers channels but is not facilities-based—failed to demonstrate that it is a MVPD entitled to seek relief under the program access rules. However, FCC has not conclusively decided the issue. Since OVDs may or may not be MVPDs, it is unclear if OVDs have the same rights to program access and obligations, such as must carry. While some OVDs like Sky Angel want to be classified as an MVPD so that they can have program access rights, other OVDs do not, saying that their business model differs from that of a MVPD and that therefore they should not be treated as one. Experts noted that complicating the distinction between OVDs and MVPDs is that some MVPDs also provide content online and on demand. Experts with whom we spoke said that defining OVDs as MVPDs could have negative implications on competition in that it could discourage companies that do not wish to be subject to MVPD regulations from entering. In response to Sky Angel's program access complaint, FCC initiated a proceeding in March 2012 requesting comments from industry stakeholders on the definition of MVPD and channel.[45]

Open Internet. The growing use of the Internet since the 1992 Act has raised concerns among some industry stakeholders about the management of broadband networks. In particular, the literature we reviewed, as well as OVDs and consumer groups with whom we spoke, reported concerns that some companies providing broadband service that are affiliated with MVPDs could favor their own content. According to the literature and stakeholders, MVPD-affiliated broadband providers might have an incentive to limit access to their programming or block or slow consumers' access to their competitors' websites, thereby giving competitive advantage to their content and restraining the growth of rivals. As we previously mentioned, limited access to content is a factor

[44]*See* 47 U.S.C. § 522 (13).

[45]Media Bureau Seeks Comment on Interpretation of the Terms "Multichannel Video Programming Distributor" and "Channel" as Raised in Pending Program Access Complaint Proceeding, 27 FCC Rcd. 3079 (2012).

that could hinder competition in the video marketplace. In December 2010, FCC issued its Open Internet Order, which provides that (1) fixed and mobile broadband providers must disclose the network management practices, performance characteristics, and terms and conditions of their broadband services; (2) fixed broadband providers may not block lawful content, applications, services, or non-harmful devices; mobile broadband providers may not block lawful websites or block applications that compete with their voice or video telephony services; and (3) fixed broadband providers may not unreasonably discriminate in transmitting lawful network traffic.[46] MVPD-affiliated broadband providers told us that they should be able to manage their networks as they built, operate, and maintain the networks and that Open Internet rules could make it more difficult for them to recoup their investments. Verizon, which provides both broadband and video services, appealed FCC's Open Internet Order in the U.S. Court of Appeals for the District of Columbia Circuit. Several parties, including the National Association of State Utility Consumer Advocates intervened in that appeal and argued, among other things, that the Commission has authority to adopt the Open Internet rules to protect against cable operators and their affiliates discriminating against their video programming competitors. Panelists at a January 2013 forum on cable and broadband law noted that any consideration of potential legislative and regulatory changes affecting the video marketplace should wait until the District of Columbia Circuit Court rules on FCC's order since the outcome could dictate how the online video marketplace evolves.

FCC Has Not Consistently Published Statutorily Required Reports

FCC is required by statute to report annually to Congress on both cable industry prices and competition in the video marketplace, but has not met this requirement every year. The 1992 Act established requirements for the purpose of increasing competition and diversity in MVPD distribution[47] and required FCC to report annually on the average rates that cable companies charge for cable service and equipment[48] and the status of competition in the video marketplace[49] to measure progress toward these

[46]Federal Communications Commission, *In the Matter of Preserving the Open Internet, Broadband Industry Practices, Report and Order*, 25 FCC Rcd. 17905 (2010).

[47]47 U.S.C. § 521(5) and (6).

[48]47 U.S.C. § 543(k).

[49]47 U.S.C. § 548(g).

goals. Since the 1992 Act, FCC has published the annual cable industry price report 13 times, but did not publish the report in 2004, 2006, 2007, and 2010. In the 2009 report, FCC included data from 2006 and 2007, in addition to the 2008 data that it would have normally reported. FCC has submitted 14 video competition reports to Congress, but did not release the report in four years—2007, 2008, 2010, and 2011. The most recent report, published in July 2012, covered 4 years of information.

FCC officials cited several factors that contributed to the missed reports, and legislation introduced in the 112th Congress would have reduced the frequency of the reports. FCC officials told us that the reports were generally prepared on time, but the delays in the release of the reports were due to a variety of administrative factors. In 2010, FCC initiated a comprehensive review of the way in which it uses data, including data used for its video competition report; ultimately, FCC altered the analytic framework of the video competition report to be consistent with its other competition reports.[50] According to FCC officials, this review and change contributed to the Commission missing the 2010 and 2011 video competition reports. In addition, FCC officials told us that the reports are time consuming to prepare because of the amount of industry data the Commission reviews. While data and comments used for the video competition report are submitted by industry participants on a voluntary basis, the cable industry price reports impose a burden on some industry participants.[51] In particular, FCC estimated that the public reporting burden for the information collection required for the cable industry price report was 6 hours per response, including the time for reviewing instructions, searching existing data sources, gathering and entering the data needed, and completing and reviewing the questionnaire.[52] Some stakeholders told us that FCC reports are valuable, although the majority of stakeholders that we interviewed had no opinion on them. In our review

[50]In particular, FCC adopted a framework consistent with its recent wireless and satellite competition reports.

[51]According to FCC officials, the video competition report does not impose a burden on industry participants because the Commission solicits information through a Notice of Inquiry, and industry participants voluntarily submit comments. However, industry participants that choose to prepare and submit comments do incur costs, reflecting staff time, attorney fees, or both.

[52]See Office of Management and Budget, Office of Information and Regulatory Affairs, ICR Reference No: 201005-3060-016, Annual Cable Price Survey and Supplemental Questions, FCC Form 333, Conclusion Date: 08/04/2010.

of the video competition reports, we saw little change in the reported findings from year to year; therefore, less frequent reporting could allow for continued measurement of industry performance while reducing the burden on FCC and industry participants. In the past, both Congress and the executive branch have expressed concern about reporting requirements; the basic concern has been that some requirements result in reports that may be unnecessarily burdensome to produce or, in some instances, not very useful. A bill that the House of Representatives passed during the 112th Congress, would have required FCC to consolidate eight currently separate congressionally mandated reports, including the video competition reports, and issue a single report biennially; the legislation would have eliminated the cable industry price report.[53] FCC officials expressed no opinion between an annual or biennial reporting requirement and said that the Commission prepares the reports as directed by Congress; the Commission has not communicated an opinion on this issue to Congress.

Conclusions

The video marketplace consists of a complex set of interrelated and competing industries operating under a variety of related laws and regulations. In particular, communications and copyright law dictate how content providers, aggregators, and distributors operate in this marketplace. Competition has expanded in some segments of the video marketplace, most notably, the emergence of telephone companies providing video distribution services. In addition, technology in this arena is changing and has facilitated the formation of entirely new businesses and products, such as online video distribution, which have the potential to alter existing business models. It is too soon to tell what the outcomes of these technological and market changes will be, or whether anticompetitive behavior would necessitate any federal action. A lack of consensus, influenced by vested economic interests among industry officials, consumer groups, and experts reinforces that while federal laws and regulations may in some ways be outdated, it is not yet clear how they should be updated to reflect 21st century technologies and market conditions. FCC's cable industry price and video competition reports provide useful information. However, these reports may not be needed on an annual basis, especially given demand on FCC staff's time for other

[53]Federal Communications Commission Consolidated Reporting Act of 2012, H.R. 3310, 112th Cong. (2012).

monitoring and regulatory duties. FCC's 2009 cable industry price and 2011 video competition reports covered several years of data and could serve as models for issuing such reports on a less frequent basis. Since these annual reports are statutorily required, Congress, with input from FCC, would determine any new reporting frequency.

Recommendation for Executive Action

To ensure that the Commission's cable industry price and video competition reports provide timely and useful information, while minimizing the reporting burden and meeting statutory deadlines, we recommend that the Chairman of the Federal Communications Commission study the advantages and disadvantages of different reporting frequencies, including annual and biennial reporting, and transmit the results of its analysis to Congress.

Agency Comments

We provided a draft of this report to the Federal Communications Commission and the Department of Justice for review and comment. FCC provided written comments, which are reprinted in Appendix II of this report. In its letter, FCC said that the Commission strives to use its resources efficiently to meet the agency's mission and its Congressional requirements, and the Commission is reviewing our recommendation. DOJ provided technical comments that we incorporated as appropriate.

We are sending copies of this report to the Attorney General and appropriate congressional committees. In addition, the report will be available at no charge on the GAO website at http://www.gao.gov.

If you or your staff have any questions concerning this report, please contact me on (202) 512-2834 or goldsteinm@gao.gov. Contact points for our offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix III.

Sincerely yours,

Mark L. Goldstein
Director, Physical Infrastructure Issues

Appendix I: Objectives, Scope, and Methodology

The objectives of this report were to examine (1) how competition has changed since 2005; (2) the increased choices that consumers have in acquiring video programming and content; (3) the factors that can spur or hinder competition; and (4) stakeholders' views on how the federal government's regulations, reports, and other activities have kept pace with changes in the industry.

To assess how competition has changed since 2005, we first conducted a literature search and reviewed media articles, academic studies, industry reports, and prior GAO reports on the structure, economics, and technological factors affecting the development and distribution of video content. We also reviewed relevant reports prepared by the Federal Communications Commission (FCC), the Department of Justice (DOJ), and the Federal Trade Commission (FTC). We verified information from the literature review through interviews with FCC and DOJ officials, industry participants, trade associations, consumer groups, industry analysts, and other experts. We selected industry participants to include producers, aggregators, and distributors of content, such as broadcast and cable networks, multichannel video programming distributors (MVPD)—cable, satellite, and telephone companies—and online video distributors (OVDs).

To assess what increased choices consumers have in acquiring video programming and content, we conducted an analysis of MVPD services in 20 randomly sampled zip codes across the United States. To ensure a representative sample, we used the Rural/Urban Commuting Area zip code file that includes all U.S. zip codes. We then sorted the zip code file into four census regions—Northeast, South, Midwest, and West—and within these regions, made five urban and rural classifications—urban, suburban, large town, small town, or isolated rural. This process resulted in 20 different segments—5 classifications for each of the 4 census regions. We then randomly sorted each of the 20 segments, a process that resulted in the identification of 20 zip codes. We identified the community names associated with the 20 zip codes using the United States Postal Service online zip code locator; we used FCC's cable franchise information to identify the MVPDs that served the communities. We contacted these MVPDs and asked them for publicly available information on their services and prices. The information requested and collected included channel lineups by package name, monthly rate for each package, broadband packages (whether provided stand-alone or combined with video services), available broadband speeds, available online video offerings, available out-of-household viewing options, and available DVR options. We had a 100 percent response rate to the survey

as all 20 communities provided information. We then analyzed the data to compare packages offered, prices, level of competition, among other factors. Our results reflect the competition, packages, and pricing in the 20 zip codes and are not generalizable to all zip codes. To identify the prices for traditional MVPD services, we gathered data from FCC's reports on cable industry prices for the years 2005 through 2012, which represent the most recent available data. These cable rates were for basic and expanded basic tiers. We reviewed FCC documentation and information provided by FCC staff to assess the reliability of the cable price data and determined that FCC's data were sufficiently reliable for the purposes of our report. We conducted interviews with content producers, MVPDs, consumer groups, and experts to collect information on reasons for the rise in cable rates.

To assess the factors that can spur or hinder competition in the video marketplace, we conducted a literature search and reviewed relevant articles and prior GAO reports, as discussed previously. Through a review of DOJ's website, we examined DOJ's activities in the video marketplace, including any investigations of potential relevant antitrust violations and the agency's review of the Comcast/NBCU proposed merger; we verified our research with DOJ. We also conducted interviews with industry participants, trade associations, consumer groups, industry analysts, and other experts for their views on factors that have increased or hindered competition. Our ability to understand some specific aspects of the industry was limited because certain information and data are generally not made publicly available. In particular, details of the contracts between content providers and MVPDs—such as retransmission fees, per subscriber fees for cable networks, and other requirements (such as tier placement) surrounding the carriage of broadcast and cable channels—are generally covered under nondisclosure agreements. Similarly, information on the negotiations for the purchase of programming by OVDs is generally not publicly available. Other areas with limited publicly available data and information include the extent to which retransmission fees are retained by local broadcast stations or flow to broadcast networks and copyright holders, the extent to which the access of content through OVD providers congests broadband providers' networks, and the cost of producing high-valued content, such as sports and popular TV dramas. As such, for some issues discussed in this report, our information is largely based on the statements and opinions of industry participants that we cannot independently corroborate.

To assess stakeholders' views on how the federal government's regulations, reports, and other activities have kept pace with changes in

the industry, we analyzed the FCC Media Bureau's activities since 2005 to determine competitive issues that the Commission has or is addressing. To do this, we reviewed the Media Bureau's website, which lists its activities. We also analyzed DOJ's investigative activities in the video marketplace through its website. We verified information collected from our reviews with FCC and DOJ. As part of this review, we reviewed the relevant laws, regulations, and FCC proceedings including Notices of Inquiry, Notices of Proposed Rulemakings, and Reports and Orders. We also conducted interviews with industry participants, trade associations, consumer groups, industry analysts, and other experts for their views on how federal regulations, reports, and activities are keeping pace with the industry. We prepared a summary analysis of all interviews that we conducted to determine the four major issues that interviewees said that Congress or the federal government should address. To determine FCC's consistency in publishing its cable industry price and video competition reports, we analyzed all reports since they were first published. In this analysis, we looked at when the reports were completed and submitted for Commission approval and when the Commission approved and published the reports. We also interviewed FCC on why the reports were not published annually.

We conducted this performance audit from July 2012 to June 2013 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: Comments from Federal Communications Commission

Federal Communications Commission
Washington, D.C. 20554

June 11, 2013

Mark Goldstein
Director, Physical Infrastructure Issues
U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Mr. Goldstein:

Thank you for the opportunity to review the Government Accountability Office (GAO) Draft Report *Competition Is Evolving, and Government Reporting Should be Reevaluated* (Draft Report).

As observed in the Draft Report, the FCC is required to report annually on cable industry prices and competition in the video marketplace. The Draft Report recognizes the utility of these reports. The Draft Report notes, however, the burden on staff resources and some industry participants in collecting the data and preparing the reports. The Draft Report recommends that the FCC study the advantages and disadvantages of producing the cable industry price and video competition reports at differing frequencies, including the current statutory mandate of reporting once a year. The Draft Report further recommends that the FCC transmit the results of its analysis to Congress.

We are reviewing GAO's recommendation. The FCC strives to use its resources efficiently in order to meet the agency's mission and its Congressional requirements. The Draft Report's recommendation comes at an important time, as we continue to consider all avenues to meet our budget goals.

Thank you for the opportunity to review the Draft Report. We look forward to working with you in the future.

Sincerely,

William T. Lake
Chief, Media Bureau

Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

Mark Goldstein, (202) 512-2834 or goldsteinm@gao.gov.

Staff Acknowledgments

Other key contributors to this report were Mike Clements (Assistant Director), Amy Abramowitz, Matt Cail, Dave Hooper, Delwen Jones, Maureen Luna-Long, Josh Ormond, and Andrew Stavisky.