UNITED STATES OF AMERICA

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FEDERAL COMMUNICATIONS COMMISSION

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A LA CARTE AND BUNDLED CHANNEL OFFERINGS IN THE SUBSCRIPTION TV INDUSTRY

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I N D E X

P R O C E E D I N G S

Time: 9:00 a.m.

MR. FERREE: I want to thank all of our presenters for coming down to join us today and participate in the symposium on cable a la carte offerings, and to welcome all of our visitors, both those that are here in the room with us and those that are watching via electronic media.

I notice that Commissioner Copps has come down to join us, and I am going to ask him if he would like to say a few opening welcome remarks. Commissioner Copps?

COMMISSIONER COPPS: Thank you, and good morning. I just wanted to come down and welcome all of you. Thank you for taking some time from your schedules to help us respond to our responsibilities to Congress on the cable a la carte proposals.

The first thing I want to do on behalf of all of my colleagues, all the Commissioners here, is to welcome you to the Commission, and we are really appreciative of your efforts this morning.

We were directed, as you know, by Congress to come up with a report to respond to the rising dialogue in this country on cable a la carte. It is an interesting question. It is one that has obviously excited a lot of interest on the part of the American people.

So we need your experience. We need your help. We need your guidance. Anything that promises to bring choices and options to consumers in the face of skyrocketing cable bills, I think, is bound to be attractive to a lot of people, both at the Commission and on Capitol Hill. Anything that holds out any hope for putting the brakes on skyrocketing cable bills, I think, is bound to be attractive to people at the Commission and people at Capitol Hill.

On the other hand, I think we have listened to concerns that have been raised about possibilities of what are the effects on diversity, on the ability to come up with new independent cable channels. Is a la carte cable pricing something that could get in the way of that? Is tiered programming something that could get in the way of that, although I think we really need to get a handle on what the reality of the situation is right now. How easy is it right now to start an independent cable company?

I think it was Ted Turner the other day said he thought it would be just about impossible for somebody like him to come along and replicate what he did.

So we need to get to the bottom of that and inform ourselves and get back to Congress, and we are very, very grateful for you folks for giving us a helping hand.

With that, I am going to sit down and listen to you. So thank you very much for coming.

MR. FERREE: Thanks, Commissioner Copps.

Well, as many of you know, I have had a keen interest in the potential and possibilities for cable a la carte pricing for some time, and indeed I am going to apologize up front, because I am going to have to duck out a little early for lunch today.

You see, coincidentally it is my wedding anniversary today, and again, as many of you may know, my wife has some fairly strongly held views about a la carte pricing, too. So I thought I ought to meet with her and get her views on this issue. But I will be joining you for the majority of both the morning session and the afternoon session today, and I look forward to your comments.

Allow me first, however, to make just a couple of general points. First, today's discussion is, by no means, the beginning nor the end of this debate. It is part of a larger process here at the FCC that we have begun to educate ourselves about a la carte cable pricings and offerings and the potential policy and practical implications of such offerings.

Most importantly, we have initiated a comment period through public notice on these issues, and we will be reviewing those written comments over the next several months in anticipation of preparing the report to which Commissioner Copps referred.

So for those of you who are observing today, if you want your voice added to this debate, I encourage you to file written comments in that docket.

Second, although many of our presenters themselves have strongly held views about a la carte pricing also, I want to emphasize here and now that this was never intended to be, and I hope it does not become, simply a platform for advocacy.

As we did in our efforts to modernize

our broadcast ownership rules and bring them into the Twenty-first Century, we want to put our emphasis today on the facts.

Now as we learned in that proceeding, the facts can sometimes scare some people, but whether they tend to show that a la carte pricing is the soul of wisdom or folly, our regulatory posture in this area should be based on facts and not fears, not ideological imperatives or, dare I say, even politics.

Third and finally, to get the most out of today's symposium we need our presenters to stay on point. This should not be regarded as an opportunity to air -- to give air to any and every grievance you may have had with either cable operators or cable programmers or the FCC or anyone else, for that matter. The symposium is on a la carte pricing. Please confine your remarks to that topic.

In a similar vein, I am going to ask you to observe any time limits that our moderator imposes. We need to hear from all of our presenters today and give them all an opportunity to deliver their remarks in full, and most importantly, we need to get out of here on time for me to get to my anniversary dinner.

So with that, I am going to turn this over to our moderator, Ben Golant.

MODERATOR GOLANT: Thank you. Good morning and welcome. This is very exciting stuff. I am thrilled to be here.

I want to give you an update of what today will be all about. You might have seen, we have some materials up front for you to gather, one of which is a schedule of events which will lay out the times in which our distinguished speakers will come to the podium and make their presentations. So if you haven't gotten one, let me just briefly go through it.

We will first have three people between now and 10:30 or whenever that might end. The first will be John Frelinghuysen, then Geraldine Laybourne, and then Jon Mandel. We will have a small break, and then we will have four more.

We will have Philip Lind, Ben Hooks, Michael Willner, and Gene Kimmelman. Then we will break for lunch.

It's not over yet. We have an exciting panel in the afternoon which will discuss the economics of bundling in a la carte, and our distinguished Chief Economist, Tracy Waldon, will lead the panel there, which will include four professors from different universities around the country.

When we get to that point, Tracy will introduce them, and we will continue our discussion up until 4:30 today.

A little bit of housecleaning: As Ken had said, we absolutely welcome written comments on this. We did extend the reply comment deadline until August 13, 2004. So please, whatever we say here, if you have any comments, that's great. We will be more than welcome to read them.

Also in terms of questioning, we will have 15 to 20 minutes where the presenter makes his or her case, and then we, the panel of Ken and Tracy and I, will be asking questions of them. We won't have any questions from the audience nor will the members or the speakers here be able to engage in a dialogue. This is not because we don't want them to. It is just to keep things in line and under control for our time constraints that we have here.

So without further ado, let me welcome our first guest, John Frelinghuysen, who is the

Vice President of the media and entertainment practice at the firm of Booz Allen Hamilton.

Mr. Frelinghuysen specializes in the strategy, development and implementation for clients in the media and entertainment industries. He has experienced leading engagements across a broad range of media businesses, including television networks, program suppliers, feature films, interactive services, sports, music and magazines.

So let's welcome our first guest. There are opportunities to have presentations via PowerPoint and other modes like that.

MR. FRELINGHUYSEN: Thank you, Ben. Good morning. I am John Frelinghuysen, and I am joined by my colleague, Matthew Egol, who is a principal with Booz Allen Hamilton. It is our pleasure to be here today to share the results of an independent study that we have prepared for an NCTA.

This is an independent study that is based on analysis and many discussions in the cable programming and the cable operator industries, and has been prepared over the last six weeks and has used a pretty extensive model, a quantitative model, to basically bring an answer to the question that many people are asking: Would consumers benefit from a potential shift to an a la carte or a themed tier or bundle for cable television?

The results of our study indicate quite clearly that, in fact, most consumers would incur higher prices for cable television in an a la carte environment, and would receive far fewer cable programs.

So in effect, a la carte, we believe, would have the implication of higher prices and less programming available.

I am going to hand this discussion over to Matt Egol, my colleague, to present the details of our report.

MR. EGOL: Thank you, John. Our fact based study addressed two main questions. First, what would be the impact on consumer pricing of a la carte or themed tiers? And second, what would be the likely impact on programming diversity?

To answer these two questions, we looked at the likely impact on the economics of both program networks and cable operators, and we looked at the impact on a broad range of segments of program networks.

We identified and quantified the likely incremental costs of establishing a la carte options. We looked at the likely impact on revenues and costs of program networks and cable operators, and we assessed the viability of different players and their ability to invest in the business going forward under different scenarios.

Booz Allen looked at three scenarios in constructing its economic model. First is what we call pure a la carte, which is a scenario in which all cable networks would be offered individual for customers to pick and choose, and at current tiers, the basic or expanded basic or digital would no longer be available to be offered as a bundle but only individual channels would be sold.

Under this scenario and all other scenarios, consumers would require to take service in digital and non-analog, given the implementation requirements of providing a la carte effectively.

In what we are determining the combined tier/a la carte scenario, consumers would have the choice between current tiered offerings that are available today, as well as a la carte channels. So that is any channel that is available in a tier could also be taken on an a la carte basis.

Similar to the first scenario, the service would be provided in a digital environment. Those consumers that migrated to a la carte would require set-top boxes in order to receive scrambled signals most effectively.

Those consumers who chose to remain with current tiers would continue to have a choice between analog and digital service.

In the third scenario, themed tiers, we looked at an illustrative set of themed tiers, for example, sports programming, entertainment programming, family friendly programming, that operators would construct and offer to consumers in addition to the current tiers.

The illustrative themed tiers range between 10 and 20 channels included based on the types of services and looking at a representative sample of networks in constructing our analysis.

Similar to the other scenarios, these would be available in digital, given the constraints of providing a la carte effectively.

Now our scenarios and our quantitative modeling differs than previous analysis that we have seen conducted, in that we've moved beyond pure a la carte, and we focus on how would the economics of a la carte differ if it were provided alongside current tiers.

For each of the scenarios that we modeled, we looked at range of responses to reflect the uncertainty of how negotiations between program networks and operators would likely play out, and the fact that there is a diverse set of networks in this environment, and that not everyone -- There is a significant degree of uncertainty.

Now what we have done in recognizing that is construct an economic model that bounds the uncertainty and focuses on a range of likely outcomes, and focuses in on the specific drivers of revenue and costs, and assesses under two responses that give you a range, and we will comment on what we think the likely outcome would be, whether the extremes or the mid-point or what have you within that range.

The first response which we have titled "Networks Increase Their Total Affiliate Fees," is one end of the extreme. In this extreme, networks raise the price of individual networks to cover any adverse impact on lost advertising and higher marketing expenses that they would incur under a la carte or themed tiers, and essentially maintain their total affiliate fees which are the wholesale subscription revenues that they receive from operators for their service, the programming costs of operators, if you will.

Under the other extreme, Response B which we have titled "Networks Reduce Their Programming Expenses," operators would not pay any additional affiliate fees to offset the adverse impacts on networks of lost advertising and higher marketing expenses. As a result, networks would be under significant financial constraint and would need to reduce their programming expenses in order to remain economically viable or achieve an attractive financial return.

What we will discuss today is, given these scenarios and the range of responses we evaluated, what are the implications for consumer prices and programming diversity?

Our primarily conclusions were that consumers would be worse off under each of the scenarios evaluated. That is, in aggregate and looking at most consumers, we recognize that there would be some consumers -- that the impact on consumers would be different.

Our findings, based on our fact-based analysis, is that the vast majority of consumers would be worse off than today. They would pay higher prices for cable, even if they kept the current tiers that are available.

They would need to receive fewer channels than they regularly watch today in order to pay less than they do today on a monthly basis. In addition, there would be substantial reduction in programming diversity in terms of the number of channels provided and that they could choose from, as well as the investment in programming on the air that they can receive.

In fact, we estimate that as many as half to three-quarters of what we classified as emerging networks would either go out of business or be sold to larger network groups, resulting in further media concentration.

Now what are the drivers of higher consumer prices, even for those that keep current service? That is, those that don't migrate to a la carte or themed tiers would pay higher prices as well. What are the reasons that led us to that conclusion, based on our economic model and our analysis?

There are four primary elements of costs associated with establishing a la carte or themed tiers. First among these is higher marketing costs that networks would incur in a changed environment.

Today networks spend between two and six percent of revenues on programming -- on the marketing in order to build brand awareness, to promote their programming, to drive tune-in. In comparison, premium networks spend between 15 and 25 percent of revenues on marketing.

They need to drive a buy decision instead of a tune-in decision, and it is a much more challenging hurdle to get someone to pay on a monthly basis for a specific channel than it is to pay for a large set of channels that provide a large diversity of options and things of interest. They would need to overcome the low brand awareness and drive a buy decision.

Second -- Oh, and that marketing cost would be borne, even if very few consumers chose a la carte, because cable networks would need to avoid the risk that consumers would choose a limited number of channels, given the low brand awareness today, and they would need to drive interest in maintaining their channel, whether or not it was a la carte or in a bundle.

Second, there are some additional costs that are associated from the cable operator's perspective of providing a la carte, in addition to the issue of whether or not they help offset any of the pressures on cable networks.

First, there is the opportunity costs of the spectrum that is required to provide duplicated signals in digital for the channels that are in analog. We have estimated a revenue impact for operators associated with the duplicated spectrum.

The second are costs that we quantified for a more complex customer care environment and higher call volumes and back office administrative requirements associated with provisioning a la carte, and fielding the large number of inquiries that we would expect from consumers around the service or longer time required in establishing new service as to which option they would prefer to choose.

Lastly, more complex billing associated with providing transactional service.

Our estimate is that consumers

maintaining their current service -- that is, not moving to a la carte -- would pay between 7 percent and 15 percent more than they do today on a monthly basis, given the costs that we have modeled in our analysis. The lower end of this range, 7 percent, reflects the likely impact if very few consumers chose a la carte. Fifteen percent reflects a range if 50 percent of consumers chose a la carte.

Now if we look at these scenarios with 50 percent of consumers migrating to a la carte, then consumers would receive a substantial price increase even if they took only 10 to 15 channels. The lower end of that range reflects an a la carte environment, scenarios 1 and 2, what we believe is likely for consumers to choose, given the regular viewing and the heavy versus light viewing of a sample of networks that we looked at. The higher end of the range, 15, represents an average of the illustrative themed tiers that we looked at.

Now I will stop for a moment. The 50 percent figure that we have used as an assumption here reflects an estimate of how many consumers might wish to consider a la carte before understanding the pricing implications for them and programming diversity implications.

Independent research that we have seen cited by other parties that have submitted reports showed as high as 66 percent of consumers, when asked would you prefer to pay for only those channels that you like, watch regularly -- 66 percent said yes. I believe that was cited in the Consumer's Union study -- testimony.

Now we conservatively used 50 percent rather than 66 percent. The actual number is not known and hasn't been quantified with a real tradeoff, if you will. What we have modeled here is, if presented with the -- If 50 percent took it, what would the costs of providing it be?

Then we looked at: Given the costs of providing it, what would likely happen? What we show here is that, if 50 percent took it, that consumers, to get only 10 to 15 channels, would pay between 14 percent and 30 percent more than they do today to move into a la carte, just to get the 10 or 15 channels. The likely impact would be that not as many as 50 percent would ultimately move to a la carte as it is played out.

I will comment briefly on the sources of that 14 to 30 percent increase. First in Response A where networks increase -- are able to capture high affiliate fees, roughly half of the increase for Scenario 1 is due to higher programming costs for the operator. That is, the network has lost advertising and higher marketing, and they are able to recover that impact from the operator.

Another substantial impact is the cost of additional set-top boxes. Seventy percent, roughly, of consumers today are in analog among cable households, and under these scenarios to move to a la carte or themed tiers they would need a set-top box on every TV in the home in which they elect to have this service.

Even digital customers don't have set-top boxes on every television in the home. What we have quantified is, given the distribution of set-top boxes today and an estimate of what the set-top boxes would be in monthly rental fees based on the low end of current prices in the market today, what would the cost be to an operator of providing them? Then we have assumed that they priced them at break even in the market.

We have quantified the cost of customer care, and we have quantified the cost of the opportunity cost of spectrum.

Rolling those all up, we get to a 14 to 30 percent impact. Thirty percent reflects one end of the range, which is if the networks were able to raise their prices to completely offset the impact on their business. Fourteen percent reflects a scenario in which the operators don't accept an increase in programming expenses. The remainder beyond programming is due to the cost of provisioning it from the operator's perspective.

We believe that the likely impact would be between A and B. That is, between these two extremes, at least the mid-point, if not skewed toward A. Our reasoning is that operators would recognize that, if they did not provide some relief in this challenging environment to networks, that the quality of the cable product would be impacted, and that with fewer networks and less programming investment, in effect a negative feedback loop in which reduction in programming led to further reductions in advertising and viewing, the operators would recognize this and would need to accept some increase in affiliate fees to offset the impact on the quality of their product, as would likely the DBS providers as well.

Therefore, we think the mid-point is

the most likely case, if not closer to A.

Now if we look at what this means for consumers if they move to a la carte, given how operators would be likely to price such a service in order to offset their higher costs and the impact on their business, we believe that our analysis demonstrates that the channels would be priced at $4.00 to $5.00 per channel for cable networks after first pricing out the broadcast basic, which is required by law to be provided.

So that operators would continue to provide broadcast basic for $15, and then would price cable networks a la carte for $4.00 to $5.00 on top of that.

The net impact of that after taking into account set-top box costs is that consumers would only be able to receive between six and nine cable networks, six if they are an analog customer, nine of they are a digital customer. This is substantially lower than the number of networks that they watch regularly today.

In addition, programming diversity would suffer under a la carte or themed tiers. We have quantified, based on our economic analysis and looking at the distribution of viewing for different sets of networks and heavy versus light viewing and who would likely be the subscribers of different types of networks under a la carte, that advertising would be impacted by as much as 20 to 60 percent for different types of networks.

The 60 percent figure is an impact that would be much more likely for an emerging network that is more dependent on occasional viewing than an established network that has a more loyal core audience. The 20 to 60 percent figure reflects both an impact on viewing as well as advertising pricing.

In addition, cable networks -- programming networks would need to spend substantially more on marketing their services, moving from an average of four percent of revenue for marketing to between 20 to 30 percent of revenue on marketing, based on cable premium networks as well as consumer goods benchmarks that are in exactly the same range as the premium networks.

As a result of this, program networks would be in a bind. They would either need to reduce their programming expenses in order to make ends meet and stay viable for me to return or they would need to sell themselves.

The implications for consumers are that they would get less -- they would have less programming diversity. They would have less choices to choose from. In fact, a la carte would reverse recent consumer benefits.

More than half the growth of cable viewing, by our estimate, is for newer networks that have only reached critical mass of 50 million viewers in the last five years or are still not there. Cable viewing has gone up by about an hour a day in the last five years, and half of that is due to newer networks.

In addition, consumers have enjoyed falling real costs per viewing hour as the amount of viewing for cable has gone up faster than the cost of cable on a real basis. So while their price inflation for cable has been greater than general inflation, consumers have enjoyed falling real costs.

In summary then, we reached some conclusions that we believe are clear. The cost of establishing a la carte or themed tiers would drive up the cost for everybody, even if they didn't choose a la carte.

Consumers would enjoy less programming diversity. They would have to choose far fewer channels than they regularly watch today, if they were to migrate to a la carte, and there would be substantial additional consolidation in cable networks.

While there is substantial uncertainty around the questions that have been addressed that we looked at in this study, we believe the uncertainty is primarily around how negative the impact would be, not on whether or not these conclusions would be realized.

Thank you.

MR. FERREE: I just have a couple of very brief questions. All of this seems to be premised on the assumption that the ad dollars are going to decrease as a result of being offered on an a la carte basis as opposed to in the bundle. Right? That is correct?

MR. EGOL: Advertising impact is one of the economic impacts that we looked at on networks. There are other additional economic impacts that are very important to our results, such as the higher marketing costs and the cost of provisioning it.

MR. FERREE: But the ad dollars -- I just want to know sort of how rigorously you tested that assumption that the ad dollars would fall. We have been told that as well. I mean, again, as I have said before, that strikes me as somewhat an irrational result. Are you just taking that for granted or did you actually do some work to test that?

MR. EGOL: Thank you. We did do quite a bit of analysis and speaking to different parties in the industry to understand the impact. We talked to a number of heads of media buying at some of the larger agencies and buying groups, in addition to talking to a diverse set of cable networks.

What we found from our analysis is that a substantial portion of the viewing of cable networks is for occasional viewing, about 25 percent. That viewing would go down as a result of a la carte, because not everyone would have access to every channel.

So there would be a clear viewing impact. Secondarily, that cable networks have in the last number of years increased their reach and become much more national services for a large number of networks. This has been very important to attract a larger number of advertisers to establish credibility.

In fact, many advertisers -- and this is borne out from our prior experiences as well as those that we talked to as part of this project -- view 50 to 70 percent coverage for both cable as well as syndicated content as kind of the threshold, if you will, for buying a national buy.

Many of the networks would fall below that threshold. In addition to that, because of the lost viewing impact, when advertisers look at their reach frequency tradeoffs, they would have to buy more cable to hit their reach target, and cable would be an inherently less attractive buy relative to other alternatives.

The natural outcome of that, that both the buyers and the networks agreed on this, was that money would likely move into broadcast or other targeted medium, and cable would draw in less dollars than before.

MR. : I think can there be, in most of the scenarios we looked at, a pretty dramatic decrease in the distribution of cable networks. As you lose that distribution, you lose the ability to deliver the impressions associated and, therefore --

MR. FERREE: Doesn't it net out the same way? Why wouldn't an advertiser pay a premium for people who are, as it were, stuck on that? IN other words, for every occasional viewer that happens upon Bravo, that person is surfing off something else.

So why wouldn't an advertiser rather have the 30 dedicated -- you know, whatever the 15 channels, pay for exposure on those channels, knowing that people, in fact, can't surf off onto some -- I mean, doesn't it net out the same way? For everybody surging on, there is somebody surfing off, isn't there?

MR. FRELINGHUYSEN: Let's explain the distinction between the distribution loss and then the pricing change from what we assumed.

MR. EGOL: The overall ratings of networks that are highly rated today would likely fall in a la carte, even with a smaller universe of channels they would compete against as networks went out of business.

We looked at heavy versus light viewing of networks. You keep more heavy viewers than light viewers in an a la carte world, because they are paying a monthly subscription fee. You are going to lose a large chunk of your viewing that comes from occasional viewing.

That doesn't mean they are just surfing through. It means that they may watch a limited number of channels. They may only watch for 20 minutes. But it helps drive your ratings. In fact, we showed that half of the growth in viewing was for newer networks, which are very dependent on occasional viewing in comparison to established networks.

So the total number of impressions that you can deliver would fall for even the largest networks that were left. That is a kind of a volume impact, if you will. There's less ratings for the established -- the remaining networks.

We also did include in our model, Ken, that with fewer networks available there would be an offsetting bump, if you will, in viewing of 10 percent in our model, that while viewing falls because of the change in the number of the people who get you, those who are left watch more, because they have fewer options. So we reflected that in our analysis.

Second is a pricing impact, that because of the fundamental change in the reach of the networks as well as the wearout effect of having to run more spots, cable would be less attractive. We have assumed in our model a 10 percent reduction in the pricing of cable inventory.

In fact, many of the agencies that we talked to said they would stop buying altogether on many of the emerging networks because of the significant loss in the distribution of those networks. The clock would be rolled back, if you will. They had been able to achieve critical mass over the last number of years, and they would be rolled back to where they were five years ago, or will never be able to get back to it.

MR. FRELINGHUYSEN: I think that, in our view, the main beneficiary of reduced distribution for cable through a la carte would be to start moving more of the ad dollars back to broadcast where those ad dollars have been migrating away from in the last several years due to advances in cable.

MR. FERREE: I don't want to take up all of the time here. So I will turn this over to you folks.

MODERATOR GOLANT: I think you have made some convincing arguments that mandatory a la carte would lead to some negative results, but I am not too convinced that voluntary a la carte or voluntary themed tiers would necessarily be bad, and they may well be good in terms of providing people with consumer choice.

Now I am premising this on several stories I have read, and I will just zip right through them. For example, in the April 15th edition of the Washington Post we have a story on "Big Dish" or "Bud" customers who now have a la carte as an option for them. It is called "Channels a la Carte: Big Dish Customers, a Dying Breed, Choose What They Pay For."

Then we have examples from Canada. I understand the Canadian situation. We will hear more about that later.

We have some examples from Europe. For example, in Spain we have Telefonica and Soge (phonetic) cable, and in France we have Numera cable, who seemingly are offering a la carte services.

Then we have B-Sky-B (phonetic) which

is super interesting in that they are actually offering, as the Wall Street Journal reports in this story, "B-Sky-B offers a flat fee for satellite TV." It says that they are offering more than 100 channels without subscription fees.

Then we have Mr. Charles Dolan (phonetic) from Cablevision Systems who testified last year before the Senate in the media ownership hearing they had. He says -- I quote: "Cablevision wishes to offer more for less to everyone. Cablevision wants its customers to be able to pick and choose among its services, selecting what appeals to them, rejecting what doesn't, determining for themselves how much they will spend, just as they do every day in the supermarket or in the shopping mall."

And, of course, we have comments in from the small cable operators represented by ACA, RCN and other similarly situated broadband service providers, EchoStar (Phonetic) among many others, who seemingly want the freedom to offer a la carte.

So with that in mind, how is it that your studies don't reflect the choices made by these very astute and smart business people in terms of what they want to offer to their consumers?

MR. EGOL: Some of the panelists that we know will follow us will talk in more detail about some of the international experiences. Our perspective -- and we looked at a range of potential scenarios in selecting these three -- was that the international experiences were not directly analogous to the three scenarios that we chose to construct, that there are some differences in how a la carte is provided in Canada or bouquets in Europe or the B-Sky-B offer that was more recently announced, from those that we constructed.

We looked at a broad range of input in developing the assumptions, if you will, in the economic model. We wanted to focus not on decisions of any one party so much as look at the collective set of input that we heard from talking to a broad range of operators and a broad range of networks, large and small, vertically integrated and not, and our own experience and analysis of nonproprietary data, to kind of cut through the negotiating positions of different parties and look at what are the drivers of revenues, what are the drivers of costs, what forces would impact them, how would that differ in an a la carte environment from today.

We believe we accurately reflected how those forces would play out on the advertising front and the marketing front, but keep the reductions in programming that would be likely to offset those from the networks' perspective.

From the operators' perspective, we looked at what would the incremental costs be of providing an a la carte service in the scenarios that we have analyzed. We can't comment on how those numbers would differ in a differently constructed scenario that we haven't analyzed.

Within the three scenarios that we did look at, that we discussed earlier, these costs of customer care, duplicated spectrum and box costs as well as potentially offsetting higher programming fees from networks would likely occur, in our view.

The operators would price their services to offset the economic impact on themselves and to maintain profitability of their customers.

MR. FRELINGHUYSEN: I think that, said another way, Ben, we looked at three specific scenarios. We had to select three. You could try to consider hundreds of different scenarios for how to package the individual networks.

We think that a lot of the discussions, such as some of the ones you mentioned in the U.S., are driven by negotiating postures and the interests of some players versus the interests of other players.

There has been a lot of discussion around the high prices of some individual networks, and some operators have commented a lot on how that could be changed if we look at those specific networks. That wasn't within the scope of our study to look at specific networks and packages, specific packages, that might have other effects other than the more general ones that we chose. You could be more specific and more detailed, and it could lead to some different results.

MODERATOR GOLANT: I will ask one more question, and pass it along to Tracy. I would like to know more about QVC and Home Shopping Channels and how -- what their business model is, what kind of cut the operators get, and how any type of a la carte scenario may affect them.

MR. FRELINGHUYSEN: I am actually not sure if we have specifically addressed that.

MR. EGOL: When we looked at the

segments of networks, we focused on six segments and didn't explicitly break out shopping channels. In fact, we looked at basic cable networks, and shopping channels would have an impact in terms of lost distribution. But we didn't explicitly model those networks. We focused on six statistically derived segments from cluster analysis.

We looked at which networks were more alike than they wee different, and we came up with general entertainment and sports, general entertainment networks that have about 25 percent of their programming in sports -- so they cluster with sports networks -- emerging mass networks, emerging niche networks, those that are not well distributed with high brand awareness, established mass networks, established niche networks, and news.

We quantified the different impacts of a la carte in these scenarios on each of those six segments, and then developed an aggregate effect based on how many of each there are.

MR. WALDON: I just have one question. You analysis requires knowledge about the responses we will see from consumers if a la carte or themed tiers are introduced. How would you suggest we go about estimating what that response might be?

MR. EGOL: In our experience conducting consumer research as part of projects that we do with clients, any substantial change in the choices available to consumers are very hard to predict in advance.

There is a cloud of uncertainty, if you will, over this that we have tried to pierce by focusing on the cost of providing it and then saying, if this is the cost of providing it -- if 50 percent took it, what would it mean, and then would people take it, and that if no one took it, would costs still go up for everybody, given the cost of establishing the option. That was our logic.

In order to more precisely quantify what the costs of a la carte -- what the response -- the price elasticity, if you will, of consumers, we would need some kind of choice analysis that presented real choices to consumers -- for example, a discrete choice or a conjoint.

Even those, in our view, when we looked at constructing the research to inform our analysis, would be very difficult to draw firm conclusions from, given the magnitude of the change that is required here, and that consumers likely would not appreciate what might result and be different in terms of the price or the programming quality.

It is very hard to kind of make it real for a consumer. Therefore, we focused on the cost of providing it, and then assessed, if prices went up by 20 percent for everybody, 50 percent wouldn't likely take it.

MR. FRELINGHUYSEN: I think other than doing that kind of hypothetical research up front, it is hard to get something meaningful unless you actually go out and test it, but not just test it in a testing environment but actually at different price points; because I think some of the research that has been presented to date looks at the hypothetical question of whether you would be interested in buying the service that way but doesn't discuss the costs you might have to incur to be able to buy it in that fashion. So --

MR. EGOL: In addition, it would have to be tested over a long enough period of time that we would witness the impacts on programming networks and in terms of programming diversity, and in a limited scale test, controlled test, you wouldn't see that because it would only have a small impact on the economics of the network for one market.

In effect, we would not know what the impact was on program networks until we couldn't reverse it.

MODERATOR GOLANT: Our next distinguished speaker is Geraldine Laybourne. She is the Chairman and CEO and founder of Oxygen Media. Ms. Laybourne has been in the business for a long time, dating back to Nickelodeon, growing that channel into a national brand.

She also worked with Disney ABC in the mid-Nineties as responsible for the current cable programming for the Walt Disney Company and ABC subsidiary at that time. She has been a long advocate and a pioneer in creating innovative and high quality television programming for children and for women, and we welcome her now, and we are honored to have her as a guest.

MS. LAYBOURNE: Thank you, Ben, and it is true. I've been around for a really long time, but thanks to my three-color process.

I have had a privilege of being a

pioneer in a great industry. I have had the privilege of watching the creation of a whole new economic base for television where there was a dual revenue stream.

I have watched cable operators underwrite the startup of virtually every cable network we have today. I have watched the difficulties of getting advertisers on board for this diverse offering. I have watched consumers spread their viewing from three channels to hundreds of channels.

I have watched consumers move their loyalty from broadcast to cable. We now get over 50 percent of all consumer viewing. I have watched Nielsen struggle to figure out how to measure this diverse landscape and, as Ben said, my claim to fame is being an advocate for the audience, women and children primarily.

I have also been an advocate for independent producers and independent voices, and a tremendous advocate for original production.

So in many ways, I share the concern of the a la carte advocates, that diversity of viewpoint is essential. That is where our sharing stops. A la carte is not the answer. In fact, it is one of the worst ideas I have ever heard. It would take us back to a world where there were fewer voices.

When we started Nickelodeon, we went out and asked kids whether or not they wanted a kids' network, and you know what they said? Absolutely not. They had no interest in it. They never heard of it. They couldn't imagine it. That is, unfortunately, true of adults as well.

I got myself quite worked up in preparation for this hearing, and I could go on and on, and I offer those services to you at any point in time. But I have been told I have a 20-minute limit. So I have limited myself to three points.

First of all, consumers would never get a new network under this scenario. You would never be able to get investors to put up financing for new launches, and that would lead to more consolidation and fewer voices.

Number two, there would be less value to consumers on the screen. (End of Tape 1/Side 1)

(Start of Tape 1/Side 2) -- to programming would have to be spent on marketing.

Number three, consumers would end up paying more for less.

So let me tell you why I believe those three things are true and use Oxygen as a living example of the Booz Allen analysis.

We are a 24-hour, ad supported programming service for young women. We have more original programming than any other woman's network, no matter how old they are.

We are the only television network in this country, and really in most of the world, that is owned and operated by women. I hear there is one in Turkey. We are one of the few independents, and we are controlled by our original founders.

My partners, Oprah Winfrey, Marcy Carsey, Karen Mandelbach (phonetic) and Tom Warner and I founded and launched Oxygen in 2000. We have grown to more than 53 million subscribers, and it wasn't an easy trip.

We know what it takes to launch, to develop, to grow an independent advertiser cable programming service. In the past 10 years I have probably done 10 business plans for new networks that required original programming, and those plans ranged from $350 million to $800 million.

A repackaged network can cost as little as $200 million, but to really bring new value to

American consumers, which is by bringing new programming, it requires that kind of intensive investment.

You cannot ever justify that kind of investment without carriage on a fully distributed programming tier, and you could never get investors to put up the money unless they saw the promise of that full distribution.

We had pre-launch commitments from TCI for 80 percent of their subscriber base on analog in analog homes. We obtained our first round of financing because of that widespread commitment from the then largest cable operator.

Within our first year of launch, we had commitments for 20 million homes, and we were able to get our next round of funding. That is what it takes to get financing in this world, a stability of distribution.

Other networks that launched when Oxygen did -- some of them agreed to take digital carriage. They will never be fully distributed, and they have harmed their business. Oxygen has stubbornly held out for analog distribution, because we are independent, and in every way. That is the only way to support investment in original productions.

A la carte or even themed tier commitments would result in uneven, uncertain distribution. The pact that the programmers and operators made early on in this business to have the operators support the emerging networks with their license fees is a formula that has worked for us in the most meaningful and profound way.

By the way, your questions about EchoStar and Britain and Canada -- I would love to have a crack at that, because the Canadian digital services do not get any kind of substantial viewers. Phil Lind will tell you that.

Even in England, I would doubt that they get the kind of viewership that the really rich and consumer serving services that we have here in this country because of the incredibly smart combination of operator and programmer in the funding of these services.

We are exactly the type of independent programming service that members of Congress and you all want to see exist. Yet we are the very networks that would be most damaged by this kind of proposition, and in fact, we would never have seen the light of day if a la carte had been on the horizon. Frankly, I can't imagine any services except for MTV that would have lived without the support of the cable operator.

Number two, a la carte carriage would increase marketing costs. It just makes sense. If you have to market yourself to your individual customers, you would have to spend much more money on marketing.

When I was at the Disney Channel, I presided over the conversion of Disney from pay to basic or from a la carte to basic. Here is probably one of the most profoundly respected brands in this country, Disney, that could not make it in an a la carte world. They could not get people to pay license fees for product that would justify a business. They couldn't create original productions, because they didn't have enough revenue from an a la carte model.

At the Disney Channel, we had almost 100 people in the marketing department. In a basic cable channel for an affiliate marketing department, it is between five and ten. The Disney Channel spent 15 to 25 percent of its revenues on marketing. A basic cable channel spends two to six percent.

So as an advocate for original programming and getting the money on the screen, and for spending two and a half decades fighting to get quality programming on the air, the idea that we would have to spend that money on marketing is just an abomination.

It is particularly poignant for independent programmers, because we don't have sister networks where we can get cross-promotion. We don't have the luxury that an NBC has with Bravo and all the support that they gave Queer Eye for a Straight Guy. We have to rely on drive-by viewing, sampling, surfing. We have to have the product in the grocery store in order for it to be picked.

We estimate that, if we were in the cable universe as an a la carte or themed tier, we would have to triple our marketing expense and basically wipe out our original programming budget.

Number three, I believe that consumers would end up paying more for less, as we were told by the Booz Allen team.

Every network would suffer subscriber loss in an a la carte environment. For independent networks, it would be more severe. These losses in subscribers would result in a loss of revenue, both from subscription and advertising.

To survive -- To even survive, we would have to increase our subscriber fees significantly and brutally reduce our costs on original programming. Consumers would end up paying more for each network, and there would be less money for good programming.

After paying for broadcast basic and rental fees for digital set-top boxes, the average analog household would be able to buy just six channels before their bill went up. My statistics say that the average consumer watches 17 channels, and that they enjoy 17 channels, but they would never be able to afford 17 channels in this environment.

So in conclusion, themed tiers or a la carte carriage are bad for companies like Oxygen. They make new launches virtually impossible. Even well established services would be in jeopardy, and emerging services, like us, would be dead.

It would be a return to the world I was born in, limited choice, only mass appeal networks, and a world where only the biggest survive. Thank you.

MR. FERREE: Thanks for that uplifting presentation, Geraldine.

MS. LAYBOURNE: This is my passion, but I have used 25 years of this.

MR. FERREE: No, I appreciate it, and thanks for coming down to do this, by the way. I have a very few and brief questions. Take your time.

I take it, you don't think audiences are overserved today. I mean, the 100 or 200 or however many channels we are getting, that is good. It is a good thing to keep expanding that range of options for people. Right? We have actually heard from some that are saying, you know what, in fact, audiences are overserved. You said 17 channels. Most people really only watch 15, 20, 30 channels, and they don't need 200 or something. But you would say, no, they should get the 200.

MS. LAYBOURNE: You know, in my household I think my husband is overserved with sports, and he thinks I am overserved with Girls Behaving Badly.

MR. FERREE: Great show, by the way.

MS. LAYBOURNE: Thank you.

MR. FERREE: But subscribers --

MS. LAYBOURNE: While you weren't the target audience for it, we do appreciate your viewership.

MR. FERREE: All other things being equal, though, you would agree, I think, that subscribers would rather have more channel options rather than fewer?

MS. LAYBOURNE: I think that we have the richest television landscape in the world, and that we did it because we were entrepreneurial, bootstrap kind of folks, and that we have something that really works.

You know, to me, when I entered this world, kids were watching broadcast networks. They were coming home from school and watching soap operas, and now they have something that is specially designed for them. I think that is great.

I think the more money we get to put on the screen with original, creative, independent voices -- When I started, there were four factories in Los Angeles that produced programming for kids. Now there are independent producers all over the country who produce for kids. It's exciting.

MR. FERREE: Okay. I will stop there. Go ahead, Ben.

MODERATOR GOLANT: I have two questions. First is: How would a la carte affect merchandising and tie-ins that some cable programming services like Nickelodeon depend upon? Would it have any adverse effect on those efforts?

MS. LAYBOURNE: It certainly would. I mean, it is very important to the retail sales to have widespread support. But that is really a tale that is so insignificant in terms of the business of television in this country. I didn't think about that, because it is so minor compared to the devastation of an entire industry.

MODERATOR GOLANT: Well, I know, because my kids are big Nickelodeon fans, and they get the magazine all the time, and Sci Fi Channel has their own magazine. So I was just trying to delve deep into that kind of thing.

MS. LAYBOURNE: Well, I share your enthusiasm for the magazine. I think it is one of the best literary magazines for kids.

MODERATOR GOLANT: My second question is this. I understand the whole debate about advertising and the effect a la carte would have on it. But I would like to know more about the advertising that we see on most cable channels, including yours, between the hours of two and eight is the paid kind of advertising.

Is that paid programming something that is based upon a broad reach of the cable channel or is it some other revenue model that is derived from that?

MS. LAYBOURNE: No, that is absolutely right. We do need a broad advertising reach. I mean, the interesting thing about Oxygen is we've just gotten to 53 million homes, and it really is, as the Booz Allen folks say -- that is a watershed number for a cable network.

It is difficult to get ratings before you get to that number. It is difficult to get a wide degree of advertisers before you get to that number. So everything is required by that.

MODERATOR GOLANT: Very good. Tracy?

MR. WALDON: Does Oxygen receive a premium in advertising rates for having an easily identifiable demographic?

MS. LAYBOURNE: At some point, we will, but as an emerging network you basically have to start at a CPM that other emerging networks are at.

So, you know, you have to earn your way. That is one of the reasons why the dual revenue stream has been so good for emerging networks.

MR. WALDON: Thank you very much.

MODERATOR GOLANT: Thanks, Gerry.

MS. LAYBOURNE; I am available at anytime.

(Applause.)

MODERATOR GOLANT: Our next distinguished guest is Jon Mandel. He is the Chief Global Buying Officer for MediaCom Worldwide, Co-CEO, MediaCom US and Co-CEO, MediaCom Latino.

He is responsible, along with Dean Kalas (phonetic), for the U.S. operations of MediaCom, which is the media services company of Gray Global Group. The 70-plus MediaCom accounts in the U.S. include Subway, Warner Brothers, and Slim Fast, as well as many Hispanic and Latino companies.

Mr. Mandel is a member of the Board of the Directors of the American Association of Advertising Agencies, and serves on the AAAA Media Policy Council. He is also a member of the International Radio and Television Society and a past Chairman of the National Association of

Television Programming Executives. So let's welcome Mr. Mandel.

MR. MANDEL: While Tracy is trying to help me get started here, let me just say: Those of you who know me at the Commission and seen me wandering the halls of Congress know that I take a certain pride, both professionally and personally, because we have no financial interest in this. We may be the only clean people here, to try and give you guys both sides of the story.

I got to say up front -- if you knew my mother, you would understand this comment: We spent, since Ben and Tracy sent the e-mail saying could you come down -- it's been about three weeks. I have talked to 450 people that work for me in New York, the 17 people in Burbank, the people in San Francisco, my peers on the Media Policy Council at the AAAA. I am real hard pressed to come up with an argument for consumers, which after all is all advertisers are interested in, for a la carte.

So I just want to lay that out. We have tried to do that. We are having a real hard time, short of doing one of those surveys where you say do you want it to be sunny tomorrow or do you want hail, rain and locusts.

I always wondered, as a side note only because I am vamping, because I don't know what is going on here -- I always wondered about the 10 or 12 percent that said give me the hail and locusts. Just a very strange thing.

Help me, I have 20 minutes. There's only 10 or 12 slides here. So it is not that big a deal, except there are some numbers. So let me sort of begin by saying, as I said before, advertisers and advertising agencies have no direct financial interest in anything that is done here at the FCC or in Congress or in the courts in what happens with the television world, radio world. However, we are impacted by FCC/Congressional actions, because we have to react to any changes.

Sometimes those actions do create market situations that can preempt the goals of government. So I think it is important that you hear our side, and I want to point out to the Booz Allen guys, my ego is crushed. You did not come and talk to me. Perhaps it is because you know I give this stuff to the government free. You guys, I have to charge, because I know you are reselling it. It's one of those things about being in business.

Further -- I am going on, Ken. Further, increased costs to advertisers are detrimental to the economy as a whole, because advertising costs are absorbed in total prices that consumers pay. Individual consumers can be further harmed if FCC actions prevent the consumer from being knowledgeable about products in the marketplace.

Our interests are the same as the viewers,' and in line with the FCC's obligation for diversity of voices in television and radio.

Now it is time for the first slide that would show you that advertisers' need for programs is both broad and deep. In the last 12 months, according to Nielsen Media Research, the number of companies advertising on cable is 2,798.

More importantly -- and this is probably the most important slide in this presentation -- the individual brands advertised on cable in the last 12 months number 12,423. That is 12,000 different target audiences. A lot of people think we just advertise to women 18 to 49. That is simply not true.

As various unintended consequences have happened of deregulation under the guise of open markets, it has in fact closed and limited our diversity of voices that we can choose from. That is why we are so worried about a la carte.

I broke the computer. What we want to do is make sure we have an effective and cost efficient medium to reach consumers. I think the most important part of that, though, is "effective." So it is essential for us that we closely examine it for unintended consequences.

Now I know that the a la carte cable issue seems to be a simplistic sort of sound bite, soluble, three-way battle between the rich MSOs and the rich cable networks, and the mice of the consumers and the seemingly uninvolved advertising mice. It is a little more complex than that.

We all know the proposed problem, that people pay for programming they don't watch, and I thinking, if you can't do that, that I got a box from Kinko's on the thing that I could give you guys all a copy of this.

If you look at the ratings, the penetration ratings -- okay? That is how much coverage there is -- and the average rating that is generated, what is really fascinating is, if you go down the list, once you hit below 50 percent, there are a number of networks that supposedly are getting zero ratings. It is because they are less than minimum reporting standards. But when you look at it, even a Discovery Channel with 82 percent coverage has a rating of a .5.

In other words, 99 -- It's almost like Ivory soap; 99.5 percent of the people ain't watching it right now or in prime time or whatever. That's a pretty big number of people paying for it, it seems.

What is interesting is there are three networks that, even that they have big penetration, do low ratings. That would be Weather Channel -- and remember this for later; Weather Channel does horrible ratings. So why do we pay for it? Oh, I love you. Okay.

If you go down the lefthand side, you can see that those are the -- It goes down in coverage levels. Discovery only does a .5. So as I said, 99.5; why are you paying for it. But go down to the Weather Channel, which is sort of in the top bottom third -- top third of the lefthand side.

It does a .2 rating with 81 percent coverage. Remember that, though. But if you look at the right side of this chart, look what happens when your penetration goes down. Look what happens to your average ratings. It's shocking. What am I buying? I am buying eyeballs. So that is important.

Now, clearly, if viewers choose by network, they would not pay for what they didn't want, assuming they knew what they wanted. But they would pay more for those networks they did want, as the viewership is not inclusive across all networks.

The simple arithmetic, if you take this chart, shows there are not enough people to carry the cost of any single network. So program quality would not be the same. Not only would the viewers have to answer the question, would you pay more for less; advertisers would not pay more for less on the programming issue.

One of the factors we look at is what we call production values. I mean, let's face it. If the show looks like you shot it with your Panasonic Omnivision, we ain't buying it or paying as much, because it doesn't have the same look and feel.

So many networks would go out of

business. Some people say that maybe they should. Okay, I've got an argument for a la carte, because advertisers -- it could be good.

Broadcast networks would once again deliver large audiences, according to our analysis. But then again, that's bad, because remember those 12,000 target audiences. Those audiences are now massified in buying it, which makes advertising expenditures highly inefficient.

One of the proofs of that I will give you: That we buy cable, billions of dollars of cable, even though over 70 percent of cable in prime time delivers less total viewers en masse than a spot on just Channel 11 in New York at two in the morning, even though on a national basis Channel 11 delivers a high rating than what you see up there. But we still buy it because of the 12,000 different targets we've got.

Now here is a problem with the networks getting bigger. Eventually, viewers would leave television as they sought out media more attuned to their individual tastes. We would then lose the most effective and efficient way to let Americans know about our products.

Now some people have said advertisers

would pay more for the chosen networks -- and I think this is somewhat where you were going, Ken -- which would make up for lost subscription revenues, because they know the viewer is more interested in the programming.

We do have experience in this area, and we know the argument on this chosen medium is somewhat false.

Magazines: The magazine editors, magazine publishers had a study that was done by the Northwestern Media Management Center, and they were trying to get at this issue. There is a big war in magazines.

If I buy it on the newsstand, I am paying full cover price. I want it. I chose it. Therefore, it is going to work harder, and there's a big fight. Conde Nast, Vogue and all those magazines -- they charge like $12 a year for a subscription. So how upscale can their audience really be, and how involved could the viewers be -- readers be?

Readers of magazines purchased at the newsstand are better subscribers. I left out all of the -- this is a 200 page report. Across magazines, it is not the case. The reader usage measure is the same, whether purchased by subscription or on newsstand. Lower subscription price paid means the reader values the magazine less. Unaffected by net subscription price. Okay? That is just one study.

Time, Inc. -- you know, they do Time, Sports Illustrated, People, InStyle, advance publications. They do all kinds of upscale stuff. They also do Parade, but they do Architectural Digest. They do Vogue. They hired McPheters & Company to do a study for them on this same issue, to determine whether or not the price and source of subscription affects reader quality.

Neither price paid nor subscription source is a substantial determinant of subscriber quality.

Now for the one client that I have that only buys television and doesn't buy any other medium, they may not know this stuff. But most of our other guys, see, they buy all media. They know this stuff. So they would not be paying more for it.

Essentially, what is happening is, when the viewer is going to that channel, he is choosing it. Okay.

Cable operators are smart, and they won't sell individual networks. They would package them in tiers. On the surface, that sounds good for advertisers. It makes cleaner, clear buys. But viewers are choosing those networks by watching them, and we follow the viewers.

I got another one for you, and than you for your comment to Gerry before. Everyone claims to watch Masterpiece Theatre, and only a few own up to craving The Bachelor. If cable operators tier, what ends up happening is you would have a women's network tier. Thirty percent -- Ken, you are not alone. Thirty percent of Oxygen's 18-plus audience is male. Okay?

Home and Garden Television would be in, Soap Net. Okay, rerun soap operators from ABC. Twenty percent of the audience is male. Now if you are a guy, are you going to admit to your cable operator? All right.

In the kids network, this is even more fascinating to me. I'm so proud to be an American. Thirty-six percent of Toon Disney is 18-plus, 36 percent of NOGTN, 35 percent of Nickelodeon.

Now why is this important? I mean, the sports networks you expect women to be into sports, but I suppose there are some people in this room that didn't think it was going to be as high as it is.

Some people assume we just buy for a given target. Well, we are also buying creatively. How are these networks going to make up for the lost audience, the lost advertising revenue, in addition to lost subscription; because we don't just buy age and sex. We are buying psychographic, and we are trying to put the creative -- just the creative.

Will we even be buying these people on television? Where does the man that likes cartoons -- where does he go? Does he do games on the Internet? Should I be advertising there? How do I fit the right commercial in whatever new environment there is? I mean, we run different commercials in news programming than we do on Cartoon Network, believe me.

The supermarket has food and other goods for the various diverse tastes of the community it serves.

This is the single most important chart that I've got. Take that same chart from before, add the weekly cume. Remember how Discovery only does -- 99.5 percent of the people don't watch it? Look at the weekly cume. In one week, close to 30 percent of American households tune to the Discovery Channel. Now it is only in 80 percent of the country. Yet 30 percent of the country tunes to it.

When you get to the other side, the penetration, the righthand side, with the exception of TV Guide Channel, which is for all those people who can't figure out where to find what's on, basically you are not cuming much. I mean, for, let's say, FUSE at a 1.9 -- that's almost down on the bottom there -- FUSE at a 1.9 weekly cume -- I mean, we probably got more people in this room -- all right? -- or go outside and just yell, and I'll get them.

Okay. So penetration is more related to cume, which is really about sampling than ratings are. That is why it is so important to us. You probably wondered why I brought my dirty underwear from yesterday up here. It's not that. It is all about the guava paste.

Back in October, I'm making a recipe my daughter wanted me to make that involved some spice I can't pronounce, and I walked down Aisle 9 in

Stop and Shop, and I discovered guava paste. I had never seen this stuff. I highly recommend it. I buy it now at Canada's (phonetic) once a month. It is fabulous on bread. With cream cheese, it's incredible. Okay? It's all about the guava paste.

The worst thing that happens to an advertiser is when the expected advertising is not delivered. That is why we expect a minimum level of committed subscribers before we can buy a new network. This ain't a charity here.

If you are not going to be on the show, who is going to watch it? So why am I going to spend my money? If I spend my money, you are going to undeliver. I don't get the advertising. I don't care, you give me the money back. I want my advertising to run.

We know that subscribers over time will turn into viewers through trial. The key thing that all marketers know is there is no purchase without trial, and there is no trial without availability and shelf space first, and then consumer knowledge of that availability.

So without the video supermarket that now exists, we couldn't support new networks. Here is further proof. This is just a few of the breakout hits that have happened in the last year or so.

Nashville Star on CMT is doing persons 18 to 49 ratings almost nine times higher than the rest of CMT. Rescue Me, which just started on Fox -- on fx on Wednesday nights, six and a half times what fx is doing.

This is just a few random ones. How many of those Rescue Me viewers, how many of the Strong Medicine viewers or Division viewers on Lifetime are -- now that they've tried it and said, hey, I discovered this, I happened into it, I like this network; I'm coming back here again. That's key. Okay?

Now a very important Senator once said -- and I am going to paraphrase it here -- the supermarket doesn't make you buy asparagus if you only want tomatoes and cucumbers. But you are still paying for the asparagus even if you don't get it.

After all, the vegan pays for part of the cost of the unsold and spoiled meat that must be discarded in the price of his bean curd. And we all pay for the loss leader price of the fabric softener, even if we don't do laundry. It's in the cost of the eggs.

The supermarket carriers flashlights and other essentials you just might need, and the cost of that inventory carriage is in your potato chips. Remember what I said about the Weather Channel does no ratings? Look what happens in what they politely call severe weather events. Okay?

The W is winter storms, Other. T is tropical. What is fascinating is the indices double and triple on a national basis. If you are on the beach in LA, you don't really -- you are not going to be turning on that the hurricane is coming in Miami. So when you look at the regional numbers, these numbers are even more frightening.

Now what are you supposed to do? Tuesday the storm is coming. I'd better call my operator and get Weather Channel? What does Allstate do? If you have a claim from the hurricane, please call this number. How are they going to do that?

So it is essential that this stuff be there and available for when you need it. Of course you could go to the greengrocer, the bakery or the local butcher. It will cost you more. And if you want a crown roast of lamb, I know my butcher, Airhart (phonetic) at Islip meat Market: I vill give it to you if you order it in advance.

We've heard before about Canada and a la carte. I am not going to argue the numbers. What doesn't work is there is no diversity requirement in Canada. In fact, there are government grants of monopolies by program type, and we crave a diversity of voices.

Even if you had just one -- I don't want just one MTV. I don't want a Canada situation, because that would be like going to the supermarket. You know, it's like more channels are added, more channels are watched and discovered and sampled. It's the guava paste.

Well, I don't want to be like Canada, because that is like saying I got to go to the supermarket, and there is only one juice. It is Ruby Red grapefruit, and there is one size, and that's it. You buy it, take it or leave it.

I'd like to point out, I am a single parent, and on school days I got to pack my daughter's lunch. I just wanted to see if I could get this through security. What if I can't get a lunchbox size? Okay. And what if -- What if sometimes she wants tomato juice. Okay?

Advertisers are no different than my daughter. It is probable that American viewers are no different either. The viewer wants a market that serves his or her television needs, but as a diverse population, that market needs to be a supermarket.

The advertiser needs to sell to people who like tomatoes, hate Brussel sprouts or that only eat hotdogs, which she did when she was eight. In both cases, the supermarket where the totality of goods and the associated costs are carried across that diverse selection and amortized over all the customers is the most efficient way for feeding the community.

Concurrently, it is the most efficient way for those who want to feed the community. So we just don't want to go back to the butcher shop, and we really believe that is what will happen to us, and our costs will go up, and goods and services will go up.

So if anybody wants any juice -- I don't know how I am going to get this on the airplane.

MR. FERREE: You sort of reminded me of Lorna Fair in Five Easy Pieces telling Jack

Nicholson, no substitutions. This is it. You know, my sense is that there are cable subscribers that would like to tell their operators to hold the chicken salad between their knees. They don't want it.

I was interested in your comment about the magazine subscriptions and the subscribers versus those that buy them off the shelf. That is a bit different, isn't it, than a cable offering that you are paying for up front, whether you want it. At least, the subscriber to a magazine expressed some interest in the content of that magazine, and the cable offerings would be more analogous to me subscribing to Newsweek and having them also send me Sports Illustrated and Playboy and Guns and Ammo or something, and charging me for all of them.

MR. MANDEL: Right. No, the subscription to a magazine would be more akin to a subscriber of a cable network saying, you know what, I want to pay -- The Weather Channel costs me 12 cents more a month; I'll take it. So that is more akin to it.

What we are trying to get at is, is there a relationship between -- If somebody chose it and said I will pay for it, do they care about the media vehicle more? Every study we have seen in the different media says there is no difference on whether they get it for free and -- The key is do you read it, in the magazine. Online, the key is do you click to it. On the radio, do you listen to it.

It is not a matter of do I pay for it. It is a matter of do I choose it, because I like it?

MR. FERREE: Okay, thanks.

MODERATOR GOLANT: I watch a cartoon network, and I play games on the Internet. So I'm a total -- but I understand that. I am also a vegetarian. So I am sad to hear that I have to pay for someone else's spoiled meat.

I'd like to ask if you can inform me about program listings in local newspapers and in the TV Guide, if you know anything about how channels get on -- what they had to do to get on, and what it would mean if there was an a la carte world.

MR. MANDEL: Well, right now one of the biggest problems that the TV Guides of the world have is how do you put it all out there. If you had an a la carte world, you would still have to do that, because you would pick 12, you would pick 13, you would pick 17 and so on.

Newspaper advertising doesn't really work as much, the listings, because if you think about it, there's sight, sound and motion on television. I mean, the Rescue Me show -- I don't know if you saw any of the promos for it, but it's these firemen, and it's fires and dragging babies out of burning buildings. I mean, it is very compelling.

Now think of how that works versus saying "Rescue Me: A story about firefighters in New York." I think one of the proofs of that is, if you ask Roopadoop (phonetic), one of the biggest problems he's got in his media properties is that TV Guide -- the networks, the over-the-air networks are spending less and less money in paying for advertising, because they are finding that it doesn't work.s

ABC has done some tests. The WB has done some tests. (Inaudible) has told me CBS did some test where they up'ed -- because you can buy it regionally -- where they are up-spending, and then other places they took it out. They saw no differences. So it's like so why am I advertising here?

Newspapers, in particular, unfortunately, happen to skew very old. So I don't think it would help Jerry's network a whole lot. I don't think it would help an MTV, FUSE, anything that skews younger. The younger male, Outdoor Life Network, it wouldn't make sense. I mean, they would probably be better off, Outdoor Life, advertising in the sports section, but even that, it's a different audience. It's just not broad enough reach, and it is not showing the movies.

MODERATOR GOLANT: Now with regard to your magazine discussion, I subscribe to at least 90 magazine, all I got free off of the Internet. But how can we learn from that industry with regard to what we are talking about with cable and satellite?

MR. MANDEL: Well, I think what we can learn from it is that the magazines that have higher production values -- I use Conde Nast folks as an example -- and there are -- I mean, Vogue is literally $12 a year.

It is one of the most upscale -- It's like all these women read Vogue. I wouldn't even say it's upscale, just because it is so many women. But that thing is crafted so well, the production values are so high, that people -- They don't read every issue.

I mean, nobody reads every issue of everything, but it is three out of four they will read, and they pick it up and they leaf through it but not read it in a given month, because they know it is giving them value.

That is one of the concerns we have. If you cut -- That's why I said we do pay for production value. Conde Nast books are some of the most expensive advertising we buy. We pay for production value, because we believe there is involvement there.

MR. WALDON: Quite a bit of the discussion on the impact of a la carte is centering on the ability of a programmer to sell advertising. Now some people have argued that the digital video recorders will significantly devalue traditional quality of advertising.

Are any of the possible developments that would respond to that any more friendly to an a la carte environment?

MR. MANDEL: Well, first of all, I am a

little bit more sanguine than my peers about the digital video recorders and how people aren't going to watch commercials anymore because, after all, we have remote controls in 98 percent of homes since 1990. So, you know, we haven't died yet.

One of my fears with a la carte is, if you get this massification again, if you make the networks big and in order -- In order to be economically to be economically viable, you have to appeal to humongous numbers of people at the same time -- that we sort of train people to find stuff they like, and the Internet is partly to blame for that. Cable is partly to blame for that. There's 17,100-something magazines now.

If we massify television, will people run more to the DVR to watch what I want to watch type of thing, when I want to watch it? Will it even be available?

I mean, how do you make it pay, even the DVR? I mean, where is the programming going to come from? This is one of the reasons why I think Oxygen, even though Gerry and I fight about how little money she says I give them -- You know, the original programming -- I mean, now I look at Nick at Nite, which is all reruns. Where is their programming going to come from 10 years from now? They don't make original programming, because there's going to be no off-network hits.

Where are the DVR programs going to come from? I mean, do we turn into all movies? Do we revitalize the movie business? I don't know. I think that it gets driven there, because the options on television will become so broad.

Anything else?

MR. FERREE: Oh, I'm sorry. I am going to just interrupt. Let me ask you what I asked Gerry. The viewers -- again, all other things being equal, and perhaps they are not. But the viewers would rather have more programming options rather than fewer. Right? Okay.

We heard from Gerry, the programmers would like to reach as many people as possible. They would like to be in as many homes as possible. So again, all other things being equal, they would rather be in more homes than fewer. Right?

MR. MANDEL: Well, they would like to be in more homes, because it's like the shelf space in the supermarket. If they are not in the home, they are never going to get discovered -- the guava paste.

MR. FERREE: Right. So your answer is yes to that as well.

MR. MANDEL: And let me give you -- Households that receive more channels do view more channels. The percentage of receivable channels decreases, but if I give you -- If I give your house 15 more channels, odds are there's going to be one you might like or two you might like, not the whole -- So that's why the percentage goes down. But you will watch one or two more.

MR. FERREE: Okay. So both viewers and programmers would like to have more programming options rather than fewer, and cable operators, presumably, would like to offer -- again, all other things being equal, would offer larger packages rather than fewer. They would want to --

MR. MANDEL: I would hope so.

MR. FERREE: They have a lot of capacity in those pipes. They don't want them just sitting there fallow, presumably.

You have told us that advertisers would rather these programmers be in more homes rather than fewer.

MR. MANDEL: I'd rather they be in more homes, and I'd rather that I have two -- I would have Stop and Shop Ruby Red, and I'd have Dole Ruby Red.

MR. FERREE: Right. So I'm sort of struggling to find any group that would have an interest in fewer rather than more. In other words, who -- You know, all these smart business people -- everybody wants all of these programming services in the homes. Where is the interest that's -- You can't figure out a way to price these in a way that most people would still end up taking most programming services, so that the advertising impacts would be de minimis for you.

You know, you wouldn't have this problem with the marketing costs and all of the things the Booz Allen folks pointed to.

MR. MANDEL: As I said, Ken --

MR. FERREE: You would all rather just see the TV industry dry up and blow away?

MR. MANDEL: Well, no. I would like to see somebody figure out a pricing model. Part of the problem is, it's almost like a negative option thing. If you can save 12 cents by not having --

MR. FERREE: People will save the 12 cents?

MR. MANDEL: I don't remember I've

watched a -- People will save the 12 cents. That's a problem.

MR. FERREE: That's the answer then.

MR. MANDEL: And they've never -- But if you haven't tried it, how do you know? That's why I say that weekly cume is so important.

MR. FERREE: Okay. Thanks, Jon.

MR. MANDEL: Really, anybody, guava paste?

MODERATOR GOLANT: We will take a short break and reconvene at 11:00 o'clock.

(Whereupon, the foregoing matter went off the record and went back on the record at 11:00 a.m.)

MODERATOR GOLANT: Steve, am I on? All right, we would like to get started again, if you all can find your seats.

Our next speaker is Philip Lind. (Several sentences inaudible). A little bit about it. It is Canada's -- one of Canada's biggest cable operators, and they are involved in both video, voice and theater communications, radio and television broadcasting and other new media businesses.

Mr. Lind is a former member of the

Board of the National Cable Television Association in the U.S. and is a former Chairman and currently serves as the Board of the Canadian Cable TV Association. He is also Chairman of the Board of the CCPTA, and in 2002 Mr. Lind was appointed to the Order of Canada. So let's welcome our next guest, Philip Lind.

MR. LIND: Thank you. Thank you inviting us to offer our assessments of the Canadian a la carte landscape. I am Phil Lind, and I am Vice Chairman of Rogers. I joined Rogers in '69, and I currently, as was said, serve on the Board of Directors, and I have been involved with programming all the way along.

With me is Ken Englehart (phonetic) who is our Vice President of Regulatory Affairs for Rogers Communications.

Just a few words about Rogers. Rogers is a diversified communications and media company engaged in cable TV, video retailing, high speed Internet, wireless broadcasting, and publishing. It conducts its business through three companies, Rogers Cable, Rogers Wireless, and Rogers Media, and has revenues of about $5 billion.

A number of years ago we provided cable

television in the States, too, and we are fortunate enough to offer it in cities such as Minneapolis and San Antonio and Portland, Oregon, and much of Orange County.

We are Canada's largest cable company, and cable accounts for about 36 percent of our total revenues. We pass about 3.2 million homes, and we serve about 2.3 million cable subscribers. So the basic cable penetration is about 71 percent, and most of our plant is upgraded to 750 megs, and 96 percent is -- (End of Tape 1/Side 2.)

(Start of Tape 2/Side 1) Along with two others -- three others, we serve probably 6.6 million customers, so 85 percent of all Canadian cable homes. An additional 2 million subscribers subscribe to DBS service, and as in the United States, an overwhelming majority of Canadian cable subscribers subscribe only to analog programming tiers, and that is true for Rogers as well.

So approximately one-quarter of our customer subscribe to digital cable. The growth of digital cable is attributed to healthy sales on our suite of bundled services combining analog cable, digital cable and Internet access. Our high speed data business continues to deliver strong growth.

We have over 800,000 subscribers for cable modem service, and those users can access the Internet at 5 megabits per second.

Rogers Wireless serves 4 million customers with voice data and messaging, and Rogers Media has 43 radio stations, cable TV stations, Rogers Sports Net, a national sports service, and we are Canada's largest publisher, newspaper -- magazine -- sorry, magazine publisher.

So over 12 million households, the number of potential cable viewers in Canada for multi-channel video programming pales in comparison to the United States. A smaller base of subscribers and eyeballs for advertising results in less revenue for original programming, and that base is even further reduced, of course, by the split in languages; because 30 percent of our population is French, although it tends to be clustered in just one province.

So there are other certain distinctions beyond demographics that set Canadian cable apart from its brethren in the U.S. Much of that is attributable to the champion of the Canadian content by government fiat. AS a result, making direct comparisons between cable systems in Canada and the U.S. is extremely difficult, as both have developed under totally different regulatory regimes.

Canadian operators and programmers live in a highly regulated world. In an effort to promote Canadian culture and diversity, the CRTC, our FCC, has specific rules for governing the development and distribution of cable programming.

The Commission's network licensing regulations have had a tremendous impact on how programming is delivered to our customers. For instance, popular cable networks residing on analog cannot be moved to digital tiers without the consent of the programmer, and specialty channels launched after 1999 can only be offered on digital. Regulations, in other words, not the marketplace, essentially shape the digital landscape in Canada.

Here are some of the other requirements. Canadian cable networks must contain a minimum of Canadian programming content. The CRTC will not license a digital channel that is directly competitive with an analog channel or a higher priority digital channel. Certain digital channels may be sold on a stand-alone basis, but must be offered as part of the package.

So it is no wonder that the take rate of digital offerings in Canada has been slow, given the constraints placed on operators with respect to what they can deliver and how they can offer it. This complexity has largely resulted in digital penetrations which, in Canada anyway, are about 22 percent compared to the 30-plus you have in the United States.

As I mentioned, Canadian consumers overwhelming buy their cable programming on analog tiers. These tiers tend to mirror the typical American expanded basic in terms of price, number of channels, and network offerings.

Popular channels on analog tiers include: A&E, CNN, the Discovery Channel, as well as home grown fare such as YTV which is our version of Nick, MUCH Music, which is our version of MTV, Sports Network which is our version of ESPN.

Some Canadian operators offer these analog channels amongst two or three tiers rather than one large tier. This is due to the fact that the government has sequentially authorized the cable carriage of different programming networks in three different batches, one in the late Eighties, one in 1995, and one in 1999.

For most cable operators, customers must purchase a package of 30 to 35 analog channels as part of the basic tier before buying into any other video channels. The basic tier is comprised largely of Canadian and U.S. local broadcasting stations, national networks, and the Canadian and educational station.

Rogers continues to enjoy great success with our analog tiers, and we believe that the customers benefit from the current model. As of this past March, 81 percent of our basic analog customers also subscribe to our expanded analog tiers.

We offer four -- We generally offer four analog packages, Basic, Classic, Me TV and Ultimate. Basic is included in all of these packages. Prices vary, depending on location. In Toronto, for example, a Basic broadcast pack costs 24 bucks a month.

Classic Combo is priced at 39.99 and contains 49 popular channels, including NE, CNN, Discovery, MUCH Music, Spike TV, Sports Network, etcetera. And ME TV pack, you get 53 channels for 38.99 a month, and this tier has a wide variety of programming, including Golf Channel, Speed Channel, History Channel.

Customers wishing to receive all of our popular analog channels can sign up for the Ultimate TV pack. This offering combines both the Classic Combo and the ME TV pack for 44.99 a month, but make no mistake. Rogers does not offer analog services on an a la carte basis. To do so would involve providing each customer with a digital box for each set at the home, and this would be a huge expense.

So let me turn now to digital. It is here that Rogers does offer some a la carte offerings, but let me emphasis that none of these a la carte offerings include the popular analog services. Those have been offered in tiers and in analog only.

So on the digital side, customers who purchase our $70 VIP Ultimate digital package receive Basic cable, the Ultimate TV tier, plus six digital themed packs. These digi-packs range from sports and family to movies and lifestyle. For an extra $15, subscribers can also get the Movie Network, Movie Pics and four U.S. superstations, again all on digital.

These digital packs can be purchased

separately as long as the customer subscribes to Basic analog and has a digital set-top box. Our English language theme packs range in price from 6.99 to 7.99, while our French language theme packs range from 4.99 to 6.99.

WE offer theme packs as a competitive response to Canada's two DBS providers, Bell Canada's Express View and Shaw's Star Choice. Both companies launched services in 1997 and offer a large array of programming networks. With over a dozen theme packs offered by each of these two, customers have a wide range of super pack pricing options, ranging from $36 to $84.

Rogers' analog customers can also purchase digital networks on an a la carte basis, but they first must purchase $32 worth of services, that being the Basic cost plus the monthly set-top box. From there, customers can pick and choose from a list of 73 typically newer specialty service channels. Price points range for a la carte range from 2.49 for one channel to 37.99 for all channels.

Channels can be selected for 2.49 each with price breaks for packs of five or 10 or 15 or 20 or 30 or 55.

So let ;me be clear. Services offered on a la carte are services available on our digital tiers, not the most popular cable services that we make available on our analog tier. Over half our customers who opt to take the digital services do so primarily to access multiplex premium movie channels. The digital theme packs are usually the better buy compared to a la carte.

A customer that selects the whole theme pack of six to nine diginet services usually spends less than picking three or four channels individually. I should note that digital channels in general are experiencing economic problems, regardless of how these are packaged. Given their limited distribution, many of the offerings are having significant difficulties attracting audiences.

The U.S. press has been quick to pick up on the subtle differences of how certain Canadian operators offer a la carte. Let me mention the situation in Quebec.

In Quebec, a province that has over 80 percent of the household speaking -- are French speaking, customers can go straight to a digital package, forgoing much of the analog purchases.

For example, a Videotron customer must get digital Basic plus a digital box before they can pick and pay for over 20 channels or 30 channels, but not individually. They just pick them 20 or 30.

If they only wanted to pick one, they still get 19 others, and the price is $22 for 20 and $30 for 30. So on the programming side in the French language areas, it is not unusual for them most popular English language networks to be offered only on a la carte and not on tiers, as there is less appeal for those services in that region.

I might add that most video customers, about 81 percent, are analog customers, period, and don't avail themselves at all of digital. So in Quebec, it is primarily an English-French thing.

I would also note that Canadian satellite operators operate digital platforms, and could offer their service on a la carte, but they do not. They offer digital -- They offer their services in theme packs. In addition, like cable, they offer the newer, less widely viewed digital services on an a la carte basis.

There is also a digital wireless MMDS operator in Canada, Con-Luck (phonetic) TV. They offered their services on an a la carte basis, but they had trouble attracting customers and went bankrupt. A la carte offerings have suffered the same fare in the United Kingdom.

So in conclusion, although our customers appreciate the additional choices of digital a la carte and theme packs, it is the analog services which is our core offering. So even with the launch of our digital services over three years ago, customers still gravitate to analog programming. Consequently, that is where we make the majority of our video revenue.

If operators in Canada or the United States, I guess, are required to offer popular networks on an a la carte basis, it would undermine the economics of our business and would harm consumers on both sides of the border.

Thank you.

MR. FERREE: Ken, do you have anything to add?

MR. ENGLEHART: No. Fire away with your questions.

MR. FERREE: Okay. Well, thanks, first of all, for coming down to help us today. I think, Phil, you proved the point that Canadians must be much smarter than Americans are to try to figure out all of those various pricing packages.

MR. LIND: Very complicated.

MR. FERREE: Which I couldn't follow, and I'm not even one of those that's watching Toon Disney in the demographic that Jon shared. But you know, one thing jumps to mind immediately as you were going through that incredibly byzantine set of choices. Why? Why do you offer so many choices? Why so many different theme tiered packages?

MR. LIND: Well, primarily because that's the way the regulation has evolved.

MR. FERREE: So the regulators require you to do a la carte there, in essence?

MR. LIND: No, the regulators probably didn't require us to do a la carte. We made that decision on our own. But the multitude of packages and everything like that is a regulatory fact of life.

MR. FERREE: Okay. To the extent you do it on your own, why do you do it? I mean, just response to consumer --

MR. LIND: Yes. Again, we offer only limited services on a la carte, but to that extent, yes, it is our choice.

MR. FERREE: Okay, thanks. Ben?

MODERATOR GOLANT: Thanks, Ken. I just have some questions about the market for video programming in Canada. Are there any cable over-builders that you compete with in any province?

MR. LIND: No.

MODERATOR GOLANT: And what is the percentage of over-the-air broadcast viewers in Canada? Do you have any idea?

MR. LIND: Over-the-air broadcast?

MODERATOR GOLANT: That don't subscribe to either satellite or cable.

MR. LIND: Well, we have 71, and they have 20. So it is over 90 percent are either satellite or cable people.

MR. ENGLEHART: About 99 percent of Canadian homes have a TV, and about 85 percent of Canadian homes have either satellite or cable. So 14 percent would just have rabbit ears.

MODERATOR GOLANT: Okay. And there is a DTV transition in Canada. Right? Is there a deadline for local broadcasters to go to DTV?

MR. ENGLEHART: No. The regulatory regime in Canada is in some ways the opposite of the U.S. Cable operators have to carry DTV when it is launched by an over-the-air station, but the over-the-air stations are under no obligation to complete the conversion by any given date.

MODERATOR GOLANT: Okay. Thank you very much.

MR. WALDON: In the United States, not all cable networks charge the same affiliate fee. I assume the situation is similar in Canada. How do you handle the problem of having a uniform per channel price that you charge to your subscribers when the affiliate fee you are paying to the network may vary widely? Do you find that subscribers always choose the most expensive network?

MR. ENGLEHART: As Phil said, although it is a uniform price, the price, of course, varies if the customer buys in bigger volume or not. Most of the digital services have a fairly similar wholesale cost, and in their license applications to the CRTS they all proposed roughly similar wholesale fees.

In order to make a business set of digital cable, because of the small penetration, you have to either re-purpose existing Canadian product or, in a lot of cases, they are Canadian versions of popular U.S. services. So they get the bulk of their programming from Tech TV or a service like that, add a bit of Canadian content, and package it that way.

So everyone has much the same business case. Anybody who wanted who couldn't make it under that business case with a roughly similar wholesale fee, had to sort of jump to a pay-TV model, $7, $8, $9, which has been used by Ethnic Services and a couple of the digital specialties.

MR. WALDON: What has been the impact of a la carte offerings on your customer service costs, billing?

MR. LIND: Well, they have been -- I don't have any numbers, but yes, they have been significant. I mean, what Booz Allen talked about here, the back office costs are -- you know, there's more when you ask people to pick. They are on the phone for a long time, higher billing costs, etcetera, etcetera. But it can be done.

MR. FERREE: Can I just follow up with one -- I'm sorry -- one final question? It wasn't clear to me when you were going through all those packages whether the services -- the digital services that are offered truly a la carte are also offered as part of a larger bundled package, in fact, maybe even on your equivalent to the Expanded Basic tier. They are not, Ken? You are shaking your head, no.

MR. ENGLEHART: No. The digital services cannot be on analog.

MR. FERREE: By government regulation?

MR. ENGLEHART: Correct.

MR. FERREE: Okay. Okay, thank you.

MR. LIND: Just remember that Canada regulation, and then you've got it right there.

MR. FERREE: Thanks, Phil.

MODERATOR GOLANT: Our next distinguished guest is Ben Hooks, the CEO, Buford Media Group. There he is the partner, Chief Executive Officer, and they do business as Allegiance Communications. He is responsible for the overall development, acquisition and operation of the company.

Mr. Hooks has been active in industry affairs for a number of years. He has committed a number of years of service to the American Cable Association, the National Cable Television Cooperative, Cable Labs, Texas Cable Telecommunications Association, and many other industry groups.

Let's welcome Mr. Hooks.

MR. HOOKS: Thank you. Good morning. My name is Ben Hooks. I am from Tyler, Texas, and I serve as CEO of Buford Media Group. We are a small cable company and operate 78 cable systems, serving about 56,000 subscribers in six states. I have been in the cable television business for 37 years, most of this time involved with small cable systems.

I am the past Chairman of American Cable Association and speak on behalf of ACA today. I am also a Board member of the National Cable Television Cooperative, the buying group that helps smaller cable operators purchase programming.

For ACA and our more than 1,000 small cable company members, this is a critically important proceeding. We work hard to serve small markets that are increasingly dominated by a few media companies. The questions members of Congress have asked go right to the heart of our deepest concerns.

Powerful interests are working to deflect scrutiny from the status quo and convince you that the only question here is about mandatory a la carte. Don't take that bait.

What is really driving this inquiry are increasing concerns in three areas: Choice, cost and content. The much more important question, the question at the heart of these concerns, is this: What limitations exist on cable operators' flexibility to offer programming choices to customers?

When you run down the list of questions Congress asked you to study, that very question is right at the top.

ACA, its staff and counsel are committed to helping you answer these important questions. I also want to thank the Media Bureau for your outstanding work in many areas. You have done a great job in understanding the tough issues facing smaller market cable operators.

Your recent work on the News Corp./DirecTV merger is a superb example. You really got it right. You concluded that a company controlling "must have" broadcast and satellite programming has substantial market power. You also found that a company can use that market power to raise costs, reduce choice, and harm customers. Finally, you concluded that smaller cable companies are particularly vulnerable.

When we boil it all down, that is the essence of ACA's input here. The exercise of market power by a few media conglomerates limits our ability to provide our customers more choice and raises costs. We want to provide more choice and better value. However, we can't.

Our comments provide detailed answers to several of the questions you asked us. With my time here, I will focus on four points.

First, I want to describe how the practices of a few dominant companies restrict choice and raise costs. To understand the limitations on our flexibility to offer programming choice, you really need to study this.

Second, I will suggest how marketplace solutions could work to bring greater flexibility and choice, and even lower costs for some customers.

Third, I want to suggest a few additional questions that will help you dig deeper here, certainly deeper than the big programmers want you to.

Finally, I will conclude with what the smaller cable sector respectfully requests that you include in your report.

To understand the limitations on how we sell programming, you need to focus on two areas -- the wholesale practices of the major program suppliers and the retransmission consent practices of the network owners and major affiliate groups. Four of the five major satellite program suppliers also control the broadcast networks. So you don't need to look far to find the culprits.

In the wholesale programming market, the distribution restrictions are imposed through programming contracts. To describe how this works, I want you to refer to Table 1, which is the next to the last page of my written testimony.

What you have there are the top 50 cable channels, organized by ownership. You see the familiar flagship "must have" channels like ESPN, Fox Sports, MTV, Nick, CNN and others. You also see that the five companies -- the Big Five we call them -- Viacom, Disney, GE/NBC, News Corp. and Time Warner -- control about 75 percent of these top 50 channels. What you don't see are the specific distribution restrictions imposed by the Big Five programmers.

Here are the rules of the game when you

play with the Big Five:

For nearly all of the top 50 channels, contracts require me to deliver each channel to all or nearly all of our customers. Everybody must receive these channels and, of course, pay for them. If I don't agree to that, I do not get to carry the channel.

For many of the top 50 channels, contracts require me to distribute and pay for affiliated channels. In some cases, this involves several additional channels. In some cases, the tie-in is mandatory. In other cases, the tie-in is coerced. For example, if I do not carry the affiliated channel, I pay double or more for the "must have" channel.

Al this combines to fill up our basic or expanded basic services with channels controlled by a few companies. But it doesn't stop there. Now that many small cable companies are upgrading to digital, the same game is being played there.

Let's look now at Table 2. That is the last page of my written testimony.

Table 2 has what we call the Second Tier channels. These are typically the channels that are included in digital packages. You see that close to half of these are controlled by three of the Big Five companies.

Initially, small cable operators had some choices in how they purchased and packaged digital channels. We could offer theme tiers, for example. That was good. But now the contracts are changing. Increasingly, we are being obligated to distribute second tier channels to all digital customers. This is undermining the little flexibility we had.

In comments you have raised, some people say cable operators, large and small, have many choices and options. Let me be clear. This is not the experience of more than 1,000 cable companies represented by ACA, because you do not see the records in the fine print of the contracts. You do not see the obligations to distribute programming to nearly all customers.

You do not see the obligations to carry affiliated channels, and you do not see the steep penalties if distribution obligations are not met, and much more.

That is one part of the problem. The other is retransmission consent.

ACA has provided the Commission with a

lot of information on retransmission consent. Here is the main problem. To obtain a "must have" network signal, we must carry affiliated satellite programming. This further restricts our flexibility and raises costs. It is a major problem for us and our customers.

This conduct continues to expand. In addition to all that we have reported to you, ACA members are now encountering retransmission consent tie-ins when they try to get consent to launch digital broadcast signals.

Certain network owners and affiliate groups are refusing to allow cable systems to distribute digital TV signals unless they agree to distribute even more affiliated programming.

When all this is taken together, it should become clear why smaller cable operators have very little flexibility in how they offer programming to customers.

This is a good place to touch upon program diversity as well. You have received many comments that argue how mandatory a la carte will hurt programming diversity. This is an important concern. But those arguments deal with a hypothetical mandatory a la carte world.

The more important question is how the current practices of the Big Five affect diversity today. There is plenty on the record about that, too, especially from independent programmers.

I will give you my own example. My systems serve several areas with good numbers of Hispanic customers. I would love to provide those local markets with more Spanish language programming on expanded basic. Right now, I cannot.

Nearly all of the channel capacity is tied up by programming controlled by the Big Five, and under my current programming contracts, if I did add another channel, it would need to be one of theirs. And the record contains other examples as well.

So when you report on what might happen to program diversity under a different wholesale regime, you should also discuss how current programming practices hurt distribution of independent channels.

For smaller operators, these problems get worse because of price discrimination. Members of Congress have asked you about this, too. As our comments indicate, ACA members' programming costs are up to 30 percent higher than what the big cable operators pay.

ACA members like me have seen this firsthand when we buy systems from major MSOs. On the day of closing, the same head-ends receive the same programming from the same satellites as the day before. The cost of producing programming didn't change. The cost of delivering the programming did not change. The only change is that the owner got smaller.

Think about what is going on here. Because of price discrimination, rural cable providers and customers are subsidizing the programming costs of their big city counterparts. Compare this to the telephone industry where it is the smaller market providers that receive the subsidy. Here we are not asking for subsidies. We are asking to end non-cost-based price discrimination.

I understand that the record contains comments from companies like Disney, Fox, NBC and Viacom. They encourage you to disregard these concerns as just the complaints of a few small cable companies. The record you have tells a different story.

In addition to ACA, you have heard from small telcos and coops that provide cable. You have heard from EchoStar, one of our biggest competitors. You have heard from many independent programmers like Oxygen Channel today, who I want to compliment, who successfully launched their channel without retransmission and tieing and bundling requirements.

You have from many independent -- Excuse me. Those groups are delivering a very similar message. Like us, they say, "Look at the current programming and retransmission consent practices of the Big Five." The problems are there. Enough about the problems for now.

Our comments describe marketplace solutions first, then a range of statutory and regulatory fixes. First let's talk about marketplace solutions.

Most of what the Big Five and other powerful interests are harping about is a dangerous, unrealistic world of mandatory a la carte. I want to talk about a different world. I want to talk about a world where smaller cable operators have more flexibility in how programming is offered locally -- to help, not harm, our customers.

Imagine this: One of my cable systems serves a market where many customers are not that interested in sports programming. Because of a struggling economy, they are much more interested in spending less for cable.

So in this imaginary world, I move high cost sports channels like ESPN and Fox Sports to a sports tier, and I reduce the costs of expanded basic service.

Imagine another example. In some of our rural markets, there is a lot of concern over the content of some programming, particularly the music video channels and some of the racier entertainment channels like E!, FX, Spike and others.

These channels contain partial nudity, sexually suggestive content and profanity. Right now the channels must be carried on expanded basic. Again we could offer them on a separate "Contemporary Adult Tier" in some markets.

I believe that just a few changes would go a long way toward addressing concerns about choice, cost and content. There is one sure way to find out. Give it a try. Let's experiment. There are small cable companies right now in ACA that are ready to try these ideas. So why isn't that happening?

That leads to my next topic, a few questions you might ask. I understand the record contains hundreds of pages describing how a national mandatory a la carte regime would be a disaster. Let's leave that aside for a moment and ask some different questions.

What about smaller scale change?

What would happen in media conglomerates allowed smaller cable operators more flexibility?

What would happen if some smaller systems had the ability to offer a Sports Tier, or a Contemporary Adult Tier?

Those of us that serve rural customers every day have some ideas about what might happen. The basic and expanded basic tier model would remain the model. Customers would just get more control over content and costs.

That leads to another question. Why won't the media conglomerates even try it in some smaller markets? Wouldn't real life experience provide better data than their fancy studies and projects?

A final question: ACA member companies are ready to step up and try this right now. What prevents the Big Five from making the same small steps. We suggest you ask them.

I want to conclude with five points that we encourage you to include in your report. The record supports these points, and Congress needs to hear them from you.

First, ACA's 1,000 smaller cable companies believe that the wholesale programming and retransmission consent practices of the media conglomerates prevent us form offering more choices to customers. A handful of companies control most of the "must have" satellite and broadcast channels we carry. They are exercising their market power to reduce choices and increase costs of cable.

Second, programming costs are higher for smaller market providers. Because of this, rural providers and customers subsidize the programming costs of the big MSOs and urban customers. There is no evidence showing that these differences are due to differences in costs. It's all about market power.

Third, ACA's 1,000 smaller cable

companies believe that more flexibility in how we package channels for customers will go a long way to address concerns about choice, cost and content.

For example, the ability to offer a sports tier or a contemporary adult tier would help us control costs and give customers more choices. This is pro-consumer, pr-competition, and will not impair the Big Five's ability to make billions from smaller markets.

Fourth, these changes will not require a mandatory a la carte regime. These changes will not necessarily require legislation or regulation, but they might. One way to achieve these changes is for the media conglomerates to exercise self-restraint when dealing with smaller distributors. They should listen to our ideas, and try them.

Finally, you can report to Congress that ACA members are ready to act, to test, and to support these changes now.

Again, I thank you for the opportunity to speak with you today. On behalf of ACA and its 1,000 member companies, I commend you on undertaking this very important study, and look forward to your report.

MR. FERREE: Thanks, Ben. You know,

the idea of a test is intriguing, obviously, and it is something that's been mentioned before. I just wonder, as we listened to the earlier presenters, whether you could sort of appropriately test something like this.

Doing an a la carte -- Allowing an a la carte offering or having an a la carte offering in a few small markets, presumably, would not have the kinds of impacts on advertising revenues for the programming services and then, derivatively, the diversity impacts that it would have potentially, or we are told, if we did this on a nationwide scale or something akin to a nationwide scale.

So how would those kinds of effects be reflected in a test market of a few small systems.

MR. HOOKS: Well, first of all, it is not that difficult, particularly on themed tiers. You know, I heard earlier comments you would have to have a box. Well, that is ridiculous. You don't need a box.

I mean, probably three-quarters of every small cable operator in the United States provides Showtime and HBO, and they don't use a box. They use a trap. So if we allocated four or five channels to a themed tier, we provide a trap.

We don't have to buy a $250 box.

So let me just say, the restrictions financially for a small operator to participate at a certain level to provide more choice -- that's not hard to do.

Finally, what I am concerned about is we got a system here that -- You know, I listen to independent programmers. I think before long they are going to tell you they can't get in that mix anymore, because the top five own and control everything.

So I just want to say -- I'm going aside here a little bit -- that tying and bundling is killing this whole system. It is putting everything out of balance. But finally, I'm concerned that, when we get outliers in our basic and expanded packages where a programmer is charging $10 a month -- well, that system won't work. I mean, you've got to separate that from the value pack.

I mean, the American way, when you go into McDonald's, is to buy "I'll take Number 3; I want the fries and Big Mac and the Coke," but when you get my age, I will pay a little more and just -- I won't buy the fries. I can't buy them anymore.

So my point is that the system we got is like a train wreck coming. You can't continue on with this model. You've got to somehow transition into more -- into more options for the customer.

MR. FERREE: Well, I understand your answer on the operational effects. I was actually getting at, you know, the theory that an a la carte world will not be amenable to advertisers reaching the kinds of audiences they need. Therefore, they will not support the programming services. Therefore, you will not have the range of diverse programming services that we have today.

It seems to me that doing a test market in Buford, Texas, is not going to tell you much about that, because no advertiser is going to discount what they pay for a programming service, because they may not be available to a few thousand homes in Buford, Texas.

MR. HOOKS: You know, I know I've heard these tests, and they confuse me. I mean, on one side a programmer says, hey, I've got 65 million households watching me. Well, that's wrong. You listen to them talk. They don't have 65 million.

There is a million.

So why does that viewership change? If there's really a million people that are interested in their product at one time, and if they price it right, why don't they still have that same million when I put it over on a tier?

I mean, i can't relate to -- Now I realize they are not getting me to pay for, you know, 65 million or whatever it is. But from the consumer standpoint, an eyeball, to me it has the same eyeballs whether it is on the tier -- Now unless they price it ridiculously. I don't know. But to me, that's not the problem. They have the same viewership whether it is on a tier or whether it is in a bundled package.

MR. FERREE: We'll leave that aside for a minute. The programming costs idea -- I mean, you referenced the $10 programming service or something, some such. To what extent do your service costs reflect a change based on the changes in programming costs?

In other words, you know, what is the most expensive programming service that you pay for?

MR. HOOKS: Well, typically, sports is

the highest priced service.

MR. FERREE: Okay. What percentage of the overall -- if you have any idea -- of a typical monthly bill captures that?

MR. HOOKS: Maybe a good way to look at that: On the average, we probably charge 50 cents a channel. I mean, if you collectively took our services and then, when you get folks that are charging three, four, on up -- I mean, if everybody started doing that, you would have serious problems in the bundled package.

I mean, you are either going to have to -- I guess the problem I got is I don't know how this system is going to prevent me from not raising rates. I mean, they talk about the rates will go higher if we make this change. Well, how are they not going to go higher if we stay the way we are, based on what they are doing right now?

That's why -- I think that's why we are here. That is what they have been doing. So I'm not hearing today compared to what. To me, compared to what, we got the same problem where we are sitting, except my customer has less choice. I got a few big companies that are saying, trust us, we know what the customer wants, and this works best for us.

So to me, you got to do something about this. This just can't continue. To me, if you don't do anything now, you are going to have me here next year. You're going to have me next time we raise rates.

MR. FERREE: Well, we can't have that. But isn't there sort of a logical fallacy in all of this, too, that for those who, as I have done, have complained that, well, you know, sports, for instance, I don't want the sports pack. It doesn't really matter, does it? I mean, I'm paying for cable service, the services that I get. And it's true, I probably only watch 20 some-odd channels on a regular basis, maybe even only surf to another 20, but whatever 20 those are, in my mind, those are worth what I'm paying. I mean, that's how a market works. Right? Whatever I am paying for my cable service --

So I may think I'm paying for ESPN and I'm not watching it, but in fact, I'm paying for Discovery and A&E and Bravo and the ones I'm watching, and I'm paying exactly what I think they are worth.

MR. HOOKS: Right. And as long as I

can secure that value to you as a consumer, I'm happy. But if I got folks dictating what the value is going to be, where it is going to be placed and what you are going to watch, and you don't have say-so, I've got the threat of you turning around a year from now saying, you know, I'm not as happy about this package of services.

So my challenge is I know the group of my customers want a package of services. Like I said, it's the American way, and I want to continue to provide that the best value possible. If something is going to interfere with that, I'm going to be up here fighting, and I see this interfering with it.

MR. FERREE: Thank you, Ben.

MR. HOOKS: I'm sort of passionate about it. I'm a Texan, too.

MODERATOR GOLANT: I'd just like to ask some questions about must-carry retransmission consent. If you had your choice, what would you like to broadcast to select must-carry or retransmission consent?

MR. HOOKS: Well, I've already supported must-carry. I think free over-the-air television is very important, and I think in essence that is -- you know, we should all support that.

Retransmission, unfortunately -- so, obviously, I would pick must-carry. Retransmission, I think, was a law that went into effect that allowed networks to leverage an issue to build a huge empire. I don't think it provided any -- (END OF TAPE 2/SIDE 1) -- for independent network. It build huge empires.

MODERATOR GOLANT: Now with regard to the basic service tier, does your company offer a lifeline or skinny basic or do you add programming to the pegged channels or the broadcast channels?

MR. HOOKS: It depends. Some of our markets do have a lifeline, which typically is broadcast, maybe a few other channels. Yes.

MODERATOR GOLANT: The last question is this. This is from an article in Multi-Channel News from October 20, 2003, from Mike Pansic (Phonetic) of the NCTC, in which he says, "A la carte is the future of cable." And he says, "There are four major changes that needed to be done to allow a la carte a chance to develop: (1) Programmers must provider operators with an a la carte rate for their services; (2) digital set-top boxes must fall below $50 per box; (3) Congress must void the retransmission consent rules; and (4) vendors must develop retail billing programs that can handle an a la carte sales tactic."

Do you agree with those, and would you add anything to those?

MR. HOOKS: I agree with that statement in general. I just don't agree that you can be where we are and change tomorrow. We got to have a transitional way to get there.

There are equipment issues. I think, if you wait long enough and the equipment issues will be resolved, which will put more pressure. But I guess -- In other words, look, I really feel like we are partners with the programmers. It's just that, if I was them and I could take advantage of retransmission and tying requirements, I got to tell you, I would probably do it. I mean, why not? I mean, I'm allowed to. So I would, and it builds a big company, and you know, my stockholders love it.

The fact is, it is not in the consumer's best interest. I think the key here is ultimately I agree, and I think you will find big and small will say someday a la carte, very likely, is going to be the rule of the game. But how you get from where we are to where we got to get is critical on how we review that.

MODERATOR GOLANT: Thank you.

MR. FERREE: Do they ever give you a cash option on the retrans side?

MR. HOOKS: Yes, that is discussed at times. Yes.

MR. FERREE: Okay. You don't want to say anything more about the cash option?

MR. HOOKS: Well, I think I said earlier I support "must carry." But, yeah, I mean it comes down to what is -- you know, how my customer feels about it. I mean, if I feel like it is a reasonable price -- I mean, I do pay some cash. You know, it's not unheard of.

I guess where I'd back up is I've heard statements that the industry refused to pay cash, and they wanted tie-ins. Well, I don't know what industry said that. I didn't. I don't like tie-ins --

MR. FERREE: We are also told by the broadcasters --

MR. HOOKS: I don't like tie-ins at all.

MR. FERREE: We are also told by the broadcasters that they offered cash options for retrans in lieu of tied programming services.

MR. HOOKS: It really comes down to what has the least pain, to be honest with you. You know, I'm still trying to bring the best value to my customer at the lowest price, and all I'm telling you, what's wrong here, is this isn't negotiation. It is kind of you got two options, take it leave it; which one works best for you.

Now what kind of negotiation is that? You know, I'm trying to stay in business. I'm trying to provide best I can to my customer at the lowest price, and this isn't negotiation. This isn't -- You know, I think retransmission, if it was just about a broadcast signal and it alone, that works. But retransmission turned into this huge company with multiple products and services that they leverage to this consideration.

MR. WALDON: I just have one question. Imagine if you faced a competitor who offered pure a la carte programming to his customers. What would your competitive response be in terms of your programming offerings?

MR. HOOKS: Well, in this imaginary

world -- Well, I certainly want to do what is in the best -- what is best for my consumer. So I guess the issue is here, and what you would find out real quickly -- if that was a major draw and it is successful, I'd certainly want to do the same thing.

MODERATOR GOLANT: Thanks, Ben.

MR. HOOKS: Thank you.

MODERATOR GOLANT: Our next speaker is Michael Willner, President and CEO, Insight Communications. Insight is the ninth largest cable operating company, serving 1.3 million cable customers living in mid-sized communities in Illinois, Indiana, Kentucky and Ohio. The company offers high definition TV, DVRs, video on demand, two tiers of high speed Internet access, voice telephony as well as standard analog video.

Active in industry organizations, Mr. Willner recently completed two consecutive terms as Chairman of the NCTA and continues to serve on its Executive Committee. He also serves on the Executive Committee of Cable Labs, on the Board of Directors of C-SPAN, the Cable Center, Walter Cates Foundation, and the Board of Trustees for Women in Cable and Telecommunications. Most importantly, he is also a graduate of Boston University's College of Communications, as am I. So I'm proud to have an alum with me.

MR. WILLNER: What year?

MODERATOR GOLANT: 1988.

MR. WILLNER: Much younger. And I especially want to thank you, Ben, for not referring to me in all those nice things that you said as a "dumb pipe." But as Ben introduced me, I am Michael Willner. I am the President and CEO of Insight Communications.

We have about 1.3 million subscribers in Illinois, Indiana, Kentucky and Ohio, and I think this is a wonderful opportunity for us all to express our views. We don't all agree with each other, obviously. I think we all have different business pressures. We are all trying to seek solutions to some very complicated problems.

I listened very intensely to Ben's testimony. Ben is a good friend, and he has different sets of problems as a smaller rural cable operator than we do, but the fact of the matter is that retransmission consent was a rule that was passed or a law that was passed that had a set of unintended consequences that resulted in certain amounts of market power consolidating into a few large companies.

It is that very result that scares me and worries me when we start talking about other solutions to either perceived or real problems that are out there in the marketplace with the government coming to the solution of creating some sort of an a la carte mandatory regime or a tiered mandatory regime, because there will be a significant series of unintended consequences that will result in a tremendous change in the way the American viewers receive their television and watch their television.

Most importantly, let us not forget that this is an industry that started 40 years ago, really got off the ground about 30 years ago, and today, along with our competitors in the satellite business, serve over 85 percent of the American public.

That is one huge success story, and I guess I always have to tell you, if it ain't broken, let's not fix it. So I come at this problem and this debate with a preconceived notion that we have been pretty successful, and we should let the marketplace continue to rule the roost here and see how close to that magic 100 percent of the industry can get.

I also listened this morning, and there were some -- John was terrific. I didn't bring any guava paste. I love coming to these things and being funny, and I have the really exciting task of talking about converters and traps and technology, which I hope doesn't bore you to tears. But I do understand how important the costs of the infrastructure will be as a cable operator if a true a la carte regime or even a forced tiered regime was put into place in a marketplace where many of our customers would need to receive devices that they don't necessarily want or we would have to install equipment in a cable system that actually is a step back from the digital transition as opposed to moving toward a complete digital transition.

I am going to focus mostly on the technical and operational problems caused by mandated a la carte. To provide such an artificially induced marketing and packaging regime, cable operators would have to spend really significant sums of money on technical and operational modifications.

This will absolutely translate into higher prices for all customers, and that is even if not one single customer opted for a la carte; because we would have to put the security systems in place to be able to offer it.

I think that the Booz Allen study shows why, and our research as an operator and our experience as an operator shows historically that few would avail themselves of this opportunity, and a very large infrastructure cost would have had to have been made in order to accomplish it.

Just briefly, you know cable services are offered today through analog and digital signals. There are no a la carte analog services that I am aware of, other than the pay services like HBO and Showtime, which we do use traps for. But those are single individual channels. and they are very low in number, and that makes it technically feasible to be able to use trap technology for those specific services. But if you start mixing and matching the 60 or 70 analog channels on an a la carte basis, we would start to line up traps.

The entire drop would be replaced by a series of traps along the way. They cause signal leakage. They have signal degradation problems. We are all operating two-way plants right now, and have very high levels of technology requirements and service requirements in order for our high speed data business to work and our telephony business to work.

So the more of these devices we put in line, the more capability that plant has of basically breaking down.

So I don't believe that the use of traps in an analog world is a step into the future, and I don't believe it is actually going to work in this world.

That brings me to set-top boxes, and there are a number of flavors of set-top boxes, but let me give you one fundamental fact about set-top boxes. There is a significant number of customers in the field today who choose the service they have specifically because they do not want a set-top box.

Those customers in the past that we have tried to force into a set-top box have reacted very negatively to that fact. I think that there would be a tremendous displacement in a large number of subscribers if the solution can't be a trap, so instead we try a set-top box solution.

We have to give those set-top boxes to everybody unless you have one hybrid system put in place, which is -- you know, it is a technologically feasible in some systems where you might have an analog and a digital simulcast of the analog channels going out over the cable plant.

In that case, there could be some customers who don't need a box, who want the analog channels. The problem with that is not every cable system has the channel capacity in the United States -- in fact, many don't have the channel capacity -- to be able to afford the six or seven or eight different channels that are out there that you need to compress the 50 or 60 channels so that you can digitize them in the homes where you want to place a box.

A government mandated a la carte regime would force us to choose one of these solutions. So we could either choose the traps, choose the digital-only box, force them on people, choose the analog-digital hybrid solution.

We could only have to deliver the box to those who want the a la carte service, but that would only be in systems that aren't already filled up to capacity, and that is not just Ben's systems. Those are big systems in big cities that are already at 750 megahertz that are providing super high speeds of HSI, high speed Internet access, that requires bandwidth, or voice telephony service which we are doing in four markets already.

For us to be able to allocate another -- Our largest system is in Louisville, Kentucky, and we can't allocate six or seven channels for simulcast right now, even though it might be a good idea. It is not available to us unless we downgrade our high speed Internet service or take away some of our telephone capability so that customers can't have an alternative phone service available to them over a cable system.

So these are all very complicated issues, and these all mean that consumers at the end of the day are going to have to pay, one way or another, for all these things to work.

I've been talking without reading. So I have to flip some pages here. There is one other technology, and that is interdiction. I am aware that one vendor filed some comments with the FCC suggesting that the technology is available that allows you to block signals from going into people's homes from outside.

It is an addressable signal security system. It has been used by a very small number of operators. I think that there is a lot of technical questions about whether or not this type of technology can be introduced nationwide. It's expensive. It requires an upgrade of plant, because of powering requirements for these outdoor devices.

That has to be powered through the coaxial cable. A whole series of other conflicts come into play with interdiction technology, and I don't see that as a feasible alternative to the current technology where the security is inside the home.

The cable industry is a little bit out of favor with Wall Street, to say it mildly, right now. I mean, cable stocks are selling at -- I don't know if it is historical or hysterical lows in terms of multiples of cash flow. It is hard for me even to crack a smile when I say that, because it is very painful.

That really does impact our ability to invest in our networks, raise capital. Remember, the cable industry raised and expended $85 billion since the passage of the 1996 Act. Every time I speak before a panel in Washington, that number goes up, because we are still spending it.

We did that without any government help. We did it without any government interference. The '96 Act encouraged investment into the cable industry. It encouraged the marketplace to work, and it allowed us to rebuild the plant.

The problem we have with Wall Street, I think, in my view, is that throughout the latter half of the 20th Century, we kept rebuilding our plant, and we kept telling Wall Street this is the last rebuild. We believed -- I mean, we weren't lying. We just felt that, you know, my God, what are we ever going to do with a 35-channel plant. We don't have enough channels to fill it. But the reality was, the more capacity we built, the more people like Gerry Laybourne could be out there as an entrepreneur, create a new programming idea, and bring it to marketplace.

In an a la carte world, Gerry Laybourne would have walked into my office, and I love her to death, but I would have thrown her right out, suggesting that I need another women's channel on my cable system in an a la carte world. It just wouldn't have worked, because our consumers would have never understood why they needed another channel that did the same thing that somebody else was doing.

An even better example is news. Fox News would never exist today in an a la carte world, and it wouldn't exist, because everybody already had CNN and MSNBC was going to launch, and that was just repurposed NBC News. You know, in an a la carte world, it would have been. And there would be no room for the kind of investment -- what did you call Rupert earlier today? Roopadoop -- Rupert Murdock would have been able to invest in order to create another news channel.

In fact, as we all know in this room, some of us like Fox News, some of us don't like Fox News, but nobody disagrees that Fox News is a very different news channel than CNN.

So those are the kinds of cause and effect results that we have to be very careful of in order to solve what are very real business problems to Ben Hooks and to me about rising cost of programming.

You know, I know Ken doesn't watch

sports programming. He has said it over and over again. We hear him, but the fix may be worse than the problem. That is what we all have to be very careful of.

Some of these solutions that I am suggesting adds up to just about another rebuild. You know, $85 billion was spent already. I've seen estimates that the set-top box solution, if everybody got a set-top box, would cost nearly $40 billion.

I can tell you for sure, we can't do it. The industry doesn't have the capital in order to create an environment where we could raise that capital in the private at-risk market as we did the first 85 billion in this 21st Century, and supply boxes to everybody.

That is not to say that this problem isn't working itself out. It isn't working itself overnight. I agree with Ben that you certainly don't want to do anything that just jolts the market. But we already offer tiers. We have many. Our digital customers have a sports and leisure time tier. They have a general entertainment tier. They have a movie tier. They have a Spanish speaking tier. Those are small genre based tiers.

We are using the technology where the technology is available to us, and we are creating tiers in a cost efficient, consumer friendly way. We are not forcing anybody to take a device on top of a TV that they don't want a device for. We are not forcing anybody to pay for anything that they don't want to pay for, and the market seems to be working.

As more and more customers take more and more digital services, there will be more and more flexibility available in the creation of new products for us to be offering them in these tiered kind of environments.

A little something about a la carte and too many tiers as a business prospect: We are working really, really hard to do something really simple -- answer our phones. We understand how important it is as cable operators, when customers have alternatives where to go for their cable services, that we have to answer our phones not with a recording but with a real live human being, do so in a relatively rapid period of time, respond to the call, go to the home and do whatever it is that the customer is asking us to do, and to nail it the first time. We understand that.

In this regime of a la carte or forced tiering, to an extent that we can't be prepared for it, we would have to either employ so many people that the infrastructure costs would be so dramatically increased as a result of just supporting that transactional type of services that this industry just isn't prepared to support, our customer service capabilities will be dramatically impacted to the negative because of all the transactions.

It would take a CSR 25 minutes to explain half of the a la carte services in an a la carte world. Customers will want them explained. They are not going to say, well, you know, two from Column A and three from Column B.

Those things will take real time, have real, real impact on the business and I think, at the end of the day, based on our experience, will not provide the vast majority of consumers with the type of service that has been so successful already that 85 percent of the American public is already subscribing to it, or buying it.

I always like to go -- I sat one night -- Our little digital tiering scheme was my idea in 1999 when we launched digital, and I went to some focus groups in, of all places, Peoria where I guess everybody goes to Peoria to figure out what Middle America is thinking, and we happen to own it.

So we went to Peoria. So it was easy. I sat in a room behind kind of a one-way glass window and microphones set up, and they knew there was a whole group of people. But we had a focus group of customers, and I did this more than once, but I'll use the Peoria example.

We asked them, you know, what do you think of the digital service, and we were doing VOD already in '99 and early 2000, and we were doing interactive services, news and information, and they liked all that stuff and they were very excited about it.

Then we asked them about our little digital programming packs, and I will tell you, I have never heard a focus group come out with a different point of view than the one in Peoria, Illinois, that said why are you confusing us with all that stuff; just give us the channels.

You know, I can make a survey come out with any answer I wanted, and I agree with John this morning again. You know, do I want it to be sunny or do I want it to hail? Well, I want it to be sunny. Do you want to be able to pick and choose your cable channels as an alternative to having the cable operator make you take 60 channels, some of which you don't want? Well, I'll tell you the right answer. I'm shocked that only 67 percent of the people said that that's what they would want.

The answer to that survey is I would rather choose the channels that I want. But when you explain to the consumer the cost implications, the technical implications, the box that half of them don't want and that is why they choose the level of service that they have and the types of services that they have, and all of the implications, the social implications we talked about this morning, I don't think 67 percent of the American people would be in favor of that, if they understood that they would have to pay as much for six or seven channels or eight or nine channels as they do today for 60 or 70, and still have options on top of that to get to the 200 and 300 channels that are really up there and out there.

So I hope we don't find ourselves on a slippery slope that we can't get ourselves off of.

That is a very dangerous place to be when we are messing with an industry that has been so successful and so creative in putting together the richest, widest ranging series of thoughts and ideas and concepts that the American people are exposed to. Like no other society on the planet Earth, we are exposed to those things, and that's a good thing, not a bad thing; and we do it all for about a dollar a day. That's not a bad thing.

That's my comments.

MODERATOR GOLANT: I have several questions, but let me first ask this. In your comments you said that a set-top box would cost about $200 for you now. But I read an article in Multi-Channel News last week that Comcast thinks that there is a $50 box on the way. Can you --

MR. WILLNER: It's a different box.

MODERATOR GOLANT: It's a different box? Okay.

MR. WILLNER: And you know, the cost of technology is coming down. We understand all that. There is going to be a day when an all-digital box -- and it's got to all-digital -- will be available for something less than $100. It might be 70; it might be 50. It might be less. But that is not an alternative that is available right now.

Right now it will cost something around $200, and that is because we still have to deliver both analog and digital signals. When we take analog away, we are forcing a box into everybody's home, and even though it may be more cost effective for me and for consumers in the long run, there are a lot of consumers out there who are not ready to stop using their television channel changing device and getting a set-top box.

MODERATOR GOLANT: Okay. Now one issue we haven't dealt with yet, and that is content that some people find objectionable on cable. I understand completely what the cable industry is doing in terms of educating consumers and providing free equipment.

I just want to ask you: If I were one of your customers and I wanted to block a cable programming service, what would you give me, and how would it work?

MR. WILLNER: It depends on the system and the technology in the system. Now, you know, if you -- We may have a large number of people that decide they want to block Oxygen. How about that for an example? And if there is a large number of people, well, you know, we might use trap technology in order to do that.

More likely, there may be some objection in Bowling Green, Kentucky, to MTV. You know, we might stock a lot of traps, and we might trap it out. But if it is a digital customer, you know, we can certainly use the digital technology, and it depends on the system, the technology, the channel capacity.

There are a number of different ways, but the industry is committed to doing this, and doing it at no cost to the consumer.

MODERATOR GOLANT: So if I wanted equipment for every single TV set for free, that would work?

MR. WILLNER: The industry is committed to giving consumers the ability to block any number and any number of television -- any number of channels and any number of televisions in their home in order to block out certain signals.

MODERATOR GOLANT: And that includes broadcast stations as well. Right?

MR. WILLNER: Well, are we allowed to do that, Robert, if a customer asks us to? I don't think we are even allowed to block a broadcast station.

MODERATOR GOLANT: Okay.

MR. WILLNER: Maybe there are one or two that we should.

MODERATOR GOLANT: I have some questions about video on demand. I see by going onto your website that one of your systems offers something called Chism (Phonetic) Limited.

MR. WILLNER: All of our systems do.

MODERATOR GOLANT: Oh, they do? Can you explain that to me, how it works?

MR. WILLNER: It is a package of VOD programming that is put together by various programming sources, including, I think, Nickelodeon and Disney. You know, we are packaging a number of programs.

One of the things we learned in some of our research is that -- I thought my kids were the only kids in the world when they were little that could watch the same program 52 times in a day, over and over and over again, and this is the kind of service where you pay a low monthly rate, and you have a VOD exposure to, you know, 50 or 100 titles for an entire month, and the kids can watch them as many times as they want.

MODERATOR GOLANT: This is like a 3.95 fee?

MR. WILLNER: Yes. I think it is 4.95.

MODERATOR GOLANT: So it could be that, because of our -- to your buy-through requirement, you buy Basic, and you can go straight to this VOD service and get all that stuff?

MR. WILLNER: You have to have a digital box.

MODERATOR GOLANT: I understand.

MR. WILLNER: And we have a very low cost digital gateway service.

MODERATOR GOLANT: The service -- you mean the box itself?

MR. WILLNER: The service is the box and some things that are embedded in the box, the guide, things like that.

MODERATOR GOLANT: Now I would like to ask you: I read in Cable World that there is a trend toward not tying tiers together, that people can buy -- you know, as you are about the roll out the Para-T (Phonetic) in the Rockford, Illinois, system, that he wouldn't have to buy another tier service to get to that tier.

MR. WILLNER: The what tier?

MODERATOR GOLANT: The Spanish language Latino tier?

MR. WILLNER: Right. Right, right.

MODERATOR GOLANT: Is that correct? Am I assuming too much or --

MR. WILLNER: You have to start with Basic and digital, and then you can buy any tier you want.

MODERATOR GOLANT: Okay. Very good. A few more questions, and this is in regard to the basic service tier and the availability of broadcasting, as well as PEG (Phonetic) channels.

Can you tell me, what, if any, are the costs for the cable operator to carry public access and broadcast signals? Let's put aside our rate regulation regime. I just want to know on a pure cost basis, what does it cost to --

MR. WILLNER: To carry broadcast signals?

MODERATOR GOLANT: And public access channels.

MR. WILLNER: Well, look, you know, I'm not sure how to allocate all of the baggage that comes along with retransmission consent agreements to the cost of a particular network's carriage of the local signal. So I don't really have an answer for you.

MODERATOR GOLANT: I understand. I was just trying to compare this, because I see on your Rockford system you have a basic service tier of $8.00, and on your Columbus system you have a basic service tier of $13.00, albeit on Columbus you have Shop, NBC, QVC and TBS, whereas in Rockford it is strictly PEG and broadcast. I am trying to differentiate -- and excluding whatever local franchise requirements there are -- why there is a difference between those two of a $5.00 difference.

MR. WILLNER: Well, there are different programming services available over those tiers of service in different markets. All of our markets have different rates that are reflective of the local economies and the local competitive nature of the business that we are in, in each of these communities.

In fact, in Columbus we have an overbuild, but we have a higher cost basic service than Rockford, which is more reflective of the service that we are offering.

I will remind you that, unless it is a

competitive market, that level of service is still regulated.

MODERATOR GOLANT: Right. Right, because I am going through in my mind -- I'm been thinking about this for ten years, ever since coming here and learning about must-carries. If a broadcast signal is free to you as an operator, it is free to me over the air with an antenna.

Then where is the cost coming from that I would have to pay for, because -- I just was going to add: Direct TV used to have broadcast signals in their local local package separately for a $5.00 fee. Now they roll it up. So it is now in effect $3.00 to pay for broadcast. EchoStar has a $5.99 local broadcast package and, as I mentioned before earlier this morning with B-Sky-B, they are offering broadcast signals for free.

MR. WILLNER: I'm the dumb pip, if you remember. I have to maintain the pipe. I have to provide free service for that pipe. Nobody who is a cable subscriber calls up and gets billed for a service call. There is a lot of infrastructure that goes into supporting it.

I will tell you that an $8.00 or $13.00 service -- that we are not making any money. I mean, that's just for the infrastructure and the support of that infrastructure.

MODERATOR GOLANT: I just need a clarification on that. It's never come through that way in what I have read.

MR. WILLNER: Well, we are not making any money there.

MODERATOR GOLANT: Okay. Thank you very much.

MR. WILLNER: Sure. Go easy on me, Tracy.

MR. WALDON: One of the concerns with a la carte is that consumers will be unable to sample unfamiliar programming. Is VOD an answer to that? I know you have some recent experiences with the Animate Channel, and I'm wondering how that has worked.

MR. WILLNER: We have a real education problem with our digital customers to get them to use VOD. You know, it goes right back to the same argument we are having about whether or not it is easy to use and you surf through it, and you stop and you like it, and all of a sudden you become a viewer.

We are going to work very hard on that

to education our VOD customers. I will tell you also that VOD is one of the marketplace solutions to this issue as we go forward, and the more and more VOD we can put out into the systems, the more and more programming consumers will have available to them on what is essentially an a la carte basis. It's just it is not a linear channel. It's different.

So the market is working. The market is transitioning. It is evolving. Now we can give it an electric shock and see what happens or we can let it continue to very successfully evolve.

Four years ago there wasn't a digital customer in the cable industry, and today about a third of our customers are digital. That's not bad. That means people are volunteering to pay us more in order to get more services from us, and VOD is very much a part of that service.

We also know that more people that use interactive services like VOD and other interactive services, the lower our churn goes, to the extent our own internal research has shown that the churn rate for digital customers who use interactive service, primarily VOD, is about 60 percent less than digital customers who don't use it.

MR. WALDON: Let's take your Columbus system. You face an overbuilder there, and we have had some people suggest that maybe there should be market tests of either a la carte or themed tier basis. What would be your competitive response if the overbuilder in Columbus was engaged in such a test? Would you feel required to follow suit or --

MR. WILLNER: Not necessarily. I mean, I do believe that that model won't work with consumers widespread. If I am proven wrong, I can be proven wrong. I thought HBO was a lousy idea when they came up with it, you know, 30 years ago, and I was proven wrong. But I do not believe that the net result of -- We're talking about two different things, first of all.

If the market dictates something, I'm okay with that, and I will respond to the marketplace. I do that every day. I also wouldn't focus particularly on Columbus as my competitive market. Every market is competitive. I either have two competitors or three competitors, and I don't really care how they are delivering their service, but they are delivering a service.

So we will respond in the marketplace to whatever comes at us. I think we are going to throw a few pitches, too, but what I wouldn't want is for the market not to be the driving force here but the government regulation being the driving force, which then results in those series of unintended consequences that I think retransmission can send is a wonderful example of.

MR. WALDON: So you are comfortable with the retransmission consent process. You wouldn't, like Mr. Hooks, suggest that all stations elect must-carry then, would you?

MR. WILLNER: Don't tempt me.

MR. WALDON: Okay.

MR. WILLNER: We are here for a la carte, right? Look, I think that there are serious issues surrounding retransmission consent, but to be frank, I don't see a path away from that in the short term future because of the process we would have to go through.

I think -- You know, I agree with Ben in the complications that that regime has caused to the American consumer, you know, the cost and complication.

MR. WALDON: And you are carrying high def signals for free. Right?

MR. WILLNER: We are carrying high def

signals for free that are available to us for free. If we pay for them, we charge for them. So some channels are on a high def tier -- right? -- and some are just on the enhanced digital gateway service, which includes high def and DVRs.

We, by the way, have deals with, I think, over half of the broadcast stations in all of our markets to carry their high def. They were all done in the marketplace. They were not done with any government regulation.

MR. WALDON: Very, very good.

MODERATOR GOLANT: Thank you very much.

MR. WILLNER: Okay.

MODERATOR GOLANT: Last but not least, we have Gene Kimmelman, who is the Senior Director of Public Policy and Advocacy for the Consumers Union. He is responsible for the management, oversight of all national public policy and advocacy activities of the Consumers Union, who are the publishers of Consumer Reports.

He specializes in a wide variety of issues, including telecommunications, cable TV, product liability, anti-trust law and health care. Prior to joining the Consumers Union in 1995, Mr. Kimmelman served for two years as Chief Counsel and

Staff Director for the Anti-Trust Subcommittee of the Senate Judiciary Committee, and prior to that he was a legislative director for the Consumer Federation of America where, during his 10-year tenure, he directed CFA's legislative, regulatory and judicial intervention programs.

MR. KIMMELMAN: Thank you. I am joined today by Dr. Mark Cooper, the Research Director with the Consumer Federation of America, who will go through a detailed analysis of all the fundamental problems with the cable industry sponsored study that was submitted in your record and a number of other things that have come up today.

Why don't we look for a minute at the world from the consumer side. You've been hearing an awful lot about "if it ain't broke, don't fix it," "the cable industry serves us well; everything is hunky-dory. We should love the programming that they dictate to consumers. We should all just be happy with it," even though prices have gone up about five times faster than inflation, if you look at overall prices; and if you even give them full credit for all those channels that they have added to your cable service that most people don't watch, they have gone up three times faster than inflation.

We don't hear from consumers that they are happy, I'm sorry to tell the cable industry. You know, I don't know. Patronizing statements that two-thirds of the public really would like to choose their own channels is somehow to be dismissed.

I would suggest to the Federal Communications Commission that it ought to be taken seriously as a problem for consumers. What they would say when they actually get a new service with a new price, you should survey them again.

These are nationwide random samples that I think tell you an important story about how consumers feel, and it is not just consumers. Independent producers -- The Center for Creative Voices in Media, independent producers in Hollywood can't get their programming on cable and broadcast networks unless they sell out to the studios owned by the networks or owned by the cable companies. They want a la carte.

Minority programmers like the Black Education Network, Christian Television Network, Urban Broadcast Company, have all filed in this proceeding, saying the system doesn't work for a lot of minority programmers, independent programmers. They cannot get their channels on cable. That is a concern.

A lot has been said here. I can't go through all the misinformation, disinformation. But let me just say a few simple things about what we are asking for, for consumers. We are not asking for anything mandatory.

Like the small cable companies, we would like to see an experiment. We would like to see the cable and satellite providers who want to offer consumers more choices and the ability to pick channels have the opportunity to do that.

We want to see a basic tier that has your local broadcast stations, your public access stations, preserved as a tier that consumers would buy, and for digital customers -- as a starting point, digital customers who already have a set-top box don't need to buy one, don't need to rent one. They have one. Give them the ability to choose any package that the cable operator and programmer is offering, wants to offer, but also the ability to choose individual channels.

Now you have heard -- Many things that

Mark will talk about are really funny assumptions, but it is amazing that today we learn you need to be in more than 15 million homes to make it in cable. I would like to read you something from the record here at the FCC.

I quote: "I am able to identify 12 basic programming services that reach fewer than 15 million subscribers -- reach fewer than 15 million subscribers in the United States in 2000."

It goes on: "Although some of these services are relatively new, two of these are more than 10 years old -- more than ten years, and four others are at least six years old, and they reach fewer than 15 million." Then there is a big table that comes with it.

This was a declaration of Stan Bessin (Phonetic) for the cable industry, arguing that you didn't need to be in even -- even 15 million homes to make it in cable -- to make it as a programmer.

He wasn't the only one. Paul Joskou (Phonetic) from MIT argued the same thing two years ago here for the cable industry. Seems to me that the cable industry today is saying that in a world without a la carte, the FCC needs to impose some more stringent ownership limits on cable companies, because that was why they were suggesting you didn't need them two years ago, that you only needed to be in a few homes, and so it didn't matter if Comcast and Time Warner were dominating cable.

There is something really disingenuous going on here in this argument. Is it today? Is it two years ago? You know, I don't know. I urge you to look at this very carefully. But what consumers want is really very, very simple. Give them more choice.

What the advertising community, Mr. Mandel suggested, is that there are a lot of people who would want a package, and there are a lot of people in the programming and cable world and advertising world who would like to see packages promoted, and that is why we are suggesting keep all the packages there. Keep them there.

Offer them in the same way that at the grocery store someone brings out a product and tries to get me to taste it. Maybe they would offer a package free for a month, at a reduced price, so that you didn't pick a la carte.

How many people would pick a la carte? None of us know, but it is not stupid for 30 percent of people responding to a survey to say that they don't want to go through the complication of picking all their channels. Probably most consumers don't want to go through that. But what about the ones who do? Shouldn't they have the choice? Shouldn't they have the option? Shouldn't advertisers have the opportunity to advertise to them directly in conjunction with all those millions who will do what many Americans do, buy the package, get the value pack.

Why the doomsday scenario? What is going on here? Why the deception? Mandatory a la carte will kill the world. Cable will disappear as we -- Nobody as asked for mandatory a la carte.

Why don't the numbers add up on how many homes you need to be in? What is going on here? Well, isn't it interesting that, as rates have skyrocketed, the company that owns ABC, the company that owns Fox, the company that has significant ownership stake in CBS, NBC, biggest other cable provider Time Warner, Turner Networks, dominate in terms of the most popular channels people watch, that dominate among the top 10, the top 20, the top 30.

What are they trying to protect? Their

most popular programming, their control, their ability to package, as Mr. Hook said, a lot of other programming that consumers don't want and don't watch? Is that what is going on here?

Seems to me, it is time for the FCC to look at the real facts, to look at where the advertising revenue really goes, to look at what fees are really paid from cable companies to programmers.

Dr. Cooper will go through the details, but for what we have suggested, we have gone back and just eliminated some of the silly things in the cable study, but we have used the core of what Booz Allen has put together.

What we find is that, for channels like Oxygen which, by the way, do have a fair amount of, I believe, Time Warner and Paul Allen, Vulcan Charter Cable industry money backing them -- For channels like that that don't get rating points, but that some people want to watch, and the 50 or 75 after that, we have looked using their model based on how much people watch who are devotees, how much people who are just occasionally watching, and said how many people are they going to lose, using these assumptions; what do they need? What are the marketing costs? What are the legitimate costs here if you are looking at digital, not at analog?

Here is what we find. Consumers can get more diversity, and they can get all the channels they want, and these companies can remain as viable as they are today. And for what they lose on a tier, based on this modeling, you know what? They might have to try to pick up, using their assumptions, by charging almost a dollar a month -- almost a dollar a month per subscriber to get back what they might have lost off the tier.

(End TAPE2/SIDE2)

(Start TAPE 3/SIDE1) -- be nice for American consumers to have the option. Pick your package or buy a lot of these channels at a more reasonable price.

We are very happy that the Congress has finally woken up to the consumer concern about this issue, and that the FCC is following through. We urge you to look carefully at the facts around this issue.

Dr. Cooper will go through in much more detail the problems with some of what you have already had submitted.

DR. COOPER: Same facts, different story. Mr. Willner reminds us that cable offers consumers choice and, as you see in Slide 1, there are choices. But the consumers are required to buy programs in three huge bites.

You have to be expanded basic. You have to buy digital tier before you get his true choice. That is about $65 and 90 channels before you get digital choice. That's $65 and 90 channels.

What we would like to do is to liberate about $25 billion of choice from the shackles of those bundles. You have to buy basic, and you have to get a digital box, and then you get your choice, and we think that is a much more inviting environment for independent programmers to compete in.

That is, you are not competing for the scraps of consumer disposal income after they have spent $65 and been forced to swallow 90 channels. You can compete for the consumer's attention and resources after 20 bucks and 16 channels. We think that is a much more friendly environment.

The cable industry's doomsday scenarios are simply wrong when applied to a mixed bundling scenario. The academic literature clearly says mixed bundling maximizes welfare.

The cable industry incorrectly claims that forcing programs into bundles increases value. This is from the Booz Allen study. You will observe that, since 2000, 26 channels have been added to the average bundle, and there has not been any movement in penetration. That is from their study compared to two charts, 26 more channels on average, no increase in penetration.

The reason is obvious. Once the number of channels in the bundle vastly exceeds the number of channels watched, you are just slicing and dicing fixed amounts of viewing time. So that viewing time has not increased a great deal. Again, this is from Booz Allen.

The total amount of viewing time on households has gone up a little bit. It has shifted from over the air to through the wire and, of course, we know that the same people owned the programs in both cases, but the amount of viewing time has not increased greatly.

In fact, the one thing that has increased greatly is the price of the bundle. So while you are adding more channels that almost nobody is watching to the bundle, you can tell me I am having a reduction in the cost per channel, but if you do the math on the cost per channel viewed, the price is going through the roof. That is what consumers are complaining about.

The average household watches fewer than a quarter of the channels that they are forced to buy in those three big bites. So their cost of viewing is increased, and we put that in the record.

Now the concentration of viewership also suggests that there will not be a sharp decline in the viewing if we move to a la carte. Again, these are combining three of the studies put in by the cable industry.

Simply put, between 20 and 30 percent of the viewers in any cable service account for 80 to 85 percent of the viewing, highly concentrated viewing. Those are a statement by Booz Allen as well as some of the other experts.

So that what happens is, given the opportunity to choose, consumers will sort themselves into three groups of customers: The devotees who really want to watch the stuff, and account for all that viewing; the grazers who go across and view certain types of programs and wander through the pasture; and the captives, who don't watch any of that stuff.

Those captives are fairly big. In the hypothetical in one of the examples given by the cable industry, they are over a third, 37 1/2 percent. So we would like to liberate those captives and give them back real choice with their purchasing dollars.

Now if advertisers are paying for eyeballs and not blank TV screens, then they ought to keep paying for those people who are actually watching. One would hope that they are not paying for blank TV screens. That is not very efficient, but if they are paying for blank TV screens, then a la carte is going to let them be much more efficient, because they will start paying for TVs that are lit up.

Now let me briefly address Mr. Mandel's comments, because they were most interesting to me, and they actually help me explain what is going on here.

Most men -- most, not all -- live in households with women. You might not have noticed that. Most children, almost all children, live in households with adults. You might not have noticed that. That is why you get cross-segment viewing. No surprise. And that is why you get lots of grazers.

Booz Allen assumes 50 percent of the people will still buy the bundle. Well, because they are made up of these heterogeneous households. But of course, TV sells and advertisers buy households. So lo and behold, this is not mystery nor is it a reasonable assumption that everyone will give up that bundle.

So the core of viewers will remain, with the grazers who are made up in these heterogeneous households and the devotees who really want to watch those shows, and we just don't see how the sky will fall.

Now the supermarket analogy is perfect. I thank you. The cable industry uses the greengrocer and the problem of, you know, if I want to buy tomatoes, I go into the supermarket and buy tomatoes. They don't make me buy peaches.

Supermarkets never engage in forced bundling, because they face vigorous competition from other supermarkets and convenience stores. And you know what? That is the environment we want on that TV screen, the right to either buy the supermarket or buy elsewhere. Not as much flexibility, because I don't have to go in the supermarket.

There is not enough competition in the video industry to force an environment that is nearly as consumer friendly or economically efficient as the supermarket industry.

A couple of other facts, and then I will have a great deal of fun with those numbers. But let me offer one other observation -- two other observations.

One: I would encourage you to take a look at the viewership of local broadcast stations during a weather event. I guaranty you, their ratings go through the roof, probably increase an awful lot more than the Weather Channel. So I love the weather channel, but the notion that somehow or another that's the only way I am going to get that information, I think, misses the point. Everything goes up that serves the news purpose when there is an event, and I challenge Mr. Mandel to give me those data.

Cumes are interesting. The cumes are far lower than the reach for those channels, and if advertisers are buying 24/7 advertising to get the cume, I am going to help them get more efficient, because that is a pretty expensive way to go.

Now let me just move on to the -- One final point. We actually prepared this, but I used his observations. This is again from the Booz Allen -- This is from a different witness. This is from, I believe, the affidavit of Owen.

We have here a plot between the distribution of subscribers, in the top, and ad dollars, and ratings in the bottom graph, and ad dollars. Anyone who knows statistics, there is a very strong direct linear relationship between viewers and ad dollars, much stronger in a multiple regression than the relationship between subscribers and ad dollars. If I ran a multiple regression, subscribers wouldn't even count.

Second observation on that graph, 25 shows, about 25 percent of the shows account for over 80 percent of the ad revenue. Highly concentrated ad revenue. We know the 25 shows. They have been the same forever. It's the big five or six that a previous witness mentioned.

Third observation: Getting 80 million subs doesn't do you a damn bit of good. You can be down at the 20 million level for advertising or up at the 800 million level for advertising. But subscribers is not what this is about. Eyeballs is what this is about, and let's not forget that. I have already shown you why you don't lose your eyeballs.

Now given the fact that the sky doesn't fall in terms of viewers and subscribers, the price doesn't go through the roof, folks. The six and eight bucks you have heard are simply wrong. If you back out some of the costs, we are down -- Gene mentioned the buck. That's a wholesale cost. The retail price would be in the couple of dollar range, which is what we observe all around the world.

But let me go on now and look at the other costs, briefly look at the other costs. We simply do not believe that you have these massive costs of unbundling. Our proposal is to let digital customers who have set-top boxes get that choice.

The industry is one-third there. In fact, more than 50 percent of American households already have digital, if we throw in satellite, and those boxes, as I understand it, are addressable.

If there is a problem of multiple TVs in a residence that need to be dealt with, the answer is, of course, something that has dawned on the rest of the digital world, a router which will then accommodate all the TVs in the house. So what we have in the analysis here is a $500 solution to a $50 problem.

We are also skeptical about the customer care costs. Remember, more than half the households in the country have already migrated to digital, and they've got the headache, which you can gladly give us, of making all these choices, just like in the supermarket.

So the customer care costs -- The start-up costs for those systems who are already selling VOD have already been incurred and, if you look at the structure of nonoperating expenses -- non-programming operating expenses, excuse me, they went way up in the late Nineties when the cable operators introduced their more complex product.

They have now begun to decline and stabilize. So this catastrophic increase in customer care costs is based on an erroneous assumption.

The opportunity cost of spectrum -- we

have our doubts. Not all systems are filled, and we know that lots of systems have lots of programs that cannot possibly be generating any revenue for the cable operators. One, no advertising revenue, nobody is watching, no subscribers. We have already seen that the last 26 have almost added none. So there is plenty of space in terms of value to give customers some choice.

Well, then the last cost we do come to is the question of the marketing and other approaches of the networks, and there is no doubt that there will be a little bit of a chance. But we don't look out at this current system as a success.

Ms. Laybourne is a drop of success in an ocean of utter failure. Think about it. Women control half -- They are half the population. We are told they control a lot more than half the discretionary income, and she is the only station serving women, and she is partly owned by the cable operators.

We had a black station come in and a Hispanic station come in, and the paucity of the representation in this marketplace is an utter failure, in spite of a couple of droplets of success.

So from our point of view, we believe that the opportunity expands. People who have been priced out of the market will come in. Independents will be able to compete for consumer's dollars and attention sooner.

The large, expensive cable operators will, in fact, have to start to discipline their pricing, because there is a threat that, if people opt out of those bundles because of a high price and their own shows are not chosen, they will begin to run the risk of having a lower quality product. Right now, they don't have to worry about it, because it is all crammed in the bundle.

Cable operators are 64 percent more likely to carry programs they own, and the broadcasters have leveraged their rights of carriage into rates of penetration, advantageous 46 percent. The independents who don't have an obligated right to carry have been squeezed out of the marketplace.

Finally, let me be clear. We reject the notion that, because cable regulation in 1992 failed -- and this is all over the comments -- a la carte must fail because it is regulation. Let's be clear. The 1992 Act was a weak set of regulatory rules, badly applied by the Commission, and you can read our comments explaining what you should have done.

But let's be clear. A la carte is not very intrusive. It simply says make the choices available. But it is much more potent, because the discipline in force is the consumer's preference.

So when we look at mixed bundling -- remember, mixed bundling; anybody talking about pure bundling, throw their comments out. They don't count. Mixed bundling creates a blue sky. The sky doesn't fall. Thank you.

MODERATOR GOLANT: Thank you very much. Let me read something to you. This is report Number CS95-29 Cable Services Action, December 1, 1995. It is a press release.

It says: "Commission affirms that Adelphia cable value package is subject to rate regulation." And it says in here, "Adelphia restructured its service to subscribers on August 30, 1993, just prior to the effective date of Commission regulations which at the time generally required cable operators to reduce rates by about 10 percent. Adelphia's restructuring involved the removal of 32 channels, or 64 percent of total channels offered, from rate regulation, and the offering of these channels individually and in an a la carte package called Cable Value. The Cable Services Bureau found that Adelphia had intended to evade rate regulation by removing 32 channels from rate regulation, thereby eliminating the entire cable programming service tier. The Bureau also found that Adelphia's per channel offering" -- and this is the important part -- "did not constitute a realistic service offering, particularly since fewer than one percent of subscribers chose individual channels instead of the package. Accordingly, the Bureau required that the channels composing the Cable Value package be counted as rate regulated channels for the purposes of rate justification as of September 1, 1993, and the Commission affirmed the Bureau's decision in full."

So let me ask: Was the Commission wrong at that time in its decision?

MR. KIMMELMAN: Absolutely not. That was a sham. The law allowed any cable operator to avoid absolutely rate regulation if it would offer a channel on a separate basis to consumers. That is not what Adelphia did.

They said they were offering them separate, and then they were packaging them again, and they were jacking up the price of the package. That is what the Commission found to be not real a la carte.

Interestingly, no one in the cable industry -- and you have heard how much they hated, absolutely despised, rate regulation. That was the last time the sky fell. Right? It was absolutely going to kill them. Nobody there was willing to do a real legitimate a la carte and avoid regulation altogether.

Mark's point is still important here. The opportunity to control what consumers get to see and how they get to see it apparently is even more important to the cable operator than having the government set the price.

DR. COOPER: I mean, the point is that you are talking about what I referred to as weak regulation badly regulated -- badly written. The fundamental logic of a simple obligation to make all programs available a la carte that are in bundles to this class of customers who already have or are likely to have, if they want, the digital capacity is a completely different beast.

You don't have to regulate rates, although I think I want to understand who gets to set the a la carte price, because I think the programmers ought to have a lot of say about the a la carte price, depending on the product that they have. But you don't have to regulate prices at all.

You don't have to tell anybody to do anything except make them available. That unleashes, in our view, that powerful force of consumers.

MODERATOR GOLANT: I have some other stuff to read. This is from Wired Magazine from June, and it is an interview with Glen Britt (phonetic) from Time Warner. The question is this from the reporter:

"Cable and satellite are in cut-throat mode. Couldn't a la carte be an opportunity for you to differentiate Time Warner Cable from its competitors?"

Mr. Britt's response was: "If that is what people wanted, yes. But the assumption is wrong. Every time we have tried to offer more packages with fewer channels, more toward a la carte, consumers always went for the big packages.

People actually like this service, which is why 90 percent of the homes in the country buy it."

Any response?

MR. KIMMELMAN: Well, I mean, as we pointed out before, it is not illogical that some consumers like a package and don't want to worry about picking everything, but that is not all consumers. The notion there that it is cut-throat competition driving it -- What we are finding is, there are only two satellite providers trying to compete with cable. One of them owns and is owned by a television network that makes its money selling programming, and it wants to drive up the price of programming.

The other satellite provider has to buy the same package of programming that Mr. Hooks was complaining about before getting sort of shoved down his throat and having to raise prices for his customers.

So we have a fundamental problem there that in this market structure no one, or very few people, have incentives to even more to a la carte, but you have an offer here from some broadband providers and small cable which we hope you will take them up on it so that we can start an experiment and see what happens.

MODERATOR GOLANT: Okay. Two more questions, and I will turn it over to Tracy. First is -- and I am amazed that satellite has gone virtually unscathed in this whole debate so far. Do you have the same concerns about satellite rates as you do for cable rates?

MR. KIMMELMAN: We have significant concerns about satellite rates. As I mentioned, you have News Corp. owning Direct TV, being a television network with stakes in dozens of cable channels, Fox News Channel, its own TV network, bundling that programming, driving up prices.

The Commission imposed some appropriate limitations in that merger on how they could behave vis a vis cable, but nothing to control the price. With one of the two satellite companies, the only two out there, that interested in driving up prices of programming, we are very concerned that we are just on an escalator curve here or prices continuing to up and up and up, even with satellite out there.

DR. COOPER: From our point of view, the interesting thing about satellite is satellite allowed customers to segment themselves along the lines that I have already talked about. So this cut-throat competition thing -- you can't find it in your data every time you look at it here at the FCC, because the elasticity is in the wrong direction, or zero.

So there is not a lot of cut-throat competition. But what satellite was before cable had a digital package was a high volume, high cost product, and satellite won all of its market share, or a substantial part of its market share, before it competed with digital.

If you look at satellite customers, especially where they compete with cable, what you discover is that three-quarters of satellite customers have sorted themselves into the high viewership market. They are the devotees. They watch lots of stuff, and so they buy additional tiers.

If you flipped that around among the lunch bucket cable crowd, they don't buy much stuff. So what they've done is sort themselves by technology between these two market segments.

Our objective here is to liberate the captives who are down in the cable section, who haven't migrated to satellite, from the bundles and ties that cable imposes on them.

MODERATOR GOLANT: Okay. My last question is about whether competition could lead to the same results you seek than any sort of government intervention and regulation?

I go and point to U.S. DTV and Ennis (Phonetic) Broadcasting who have planned or are now planning to offer a multi-channel video program package via their DTV spectrum. I printed out from U.S. DTV's website the three channel line-up cards that they offer in Albuquerque, Salt Lake City, and Las Vegas.

Las Vegas offers 22 channels. In Albuquerque, New Mexico, there's 23 channels, and in Salt Lake City there are 32 channels, all of which are available to consumers for $19.99 plus the cost of the set-top box.

Don't you think we should perhaps recommend to Congress that we are better served to take these brilliant ideas for the DTV spectrum and promote them as much rather than concentrate on the a la carte debate?

DR. COOPER: Well, look, we love competition, and it has taken the people who hold the DTV section almost ten years to figure out that there might be a business model out there that might actually bring another player to the marketplace. So we think you should encourage them.

We would actually suggest, too, that cable open access would be a real neat way to go. That would introduce immense competition in the content market, if people could use that dump pipe, rent it at a fair price, and deliver content. That would really -- We have supported that for five or six years.

So we are all for competition, but it is not -- It's time for consumers to get some relief from this bundle which has begun to eat their wallets. So waiting for these other technologies or waiting until I can out-lobby the cable industry on open access is not going to provide us any relief anytime soon.

MR. KIMMELMAN: I would just like to echo. We want the competition. I have to look at their model as to how they choose the channels, and again is there enough consumer input in how the channels truly get selected.

Certainly, if broadcasters want to use their digital spectrum to offer consumers more diversity or more options that are not totally under their control, under their ownership, that would be a wonderful thing.

DR. COOPER: One other point is that I would ask -- You should ask yourself the question whether requiring a mixed bundling environment hurts them. As far as I can tell, it would not. If they've got a product to sell, it should not hurt them.

So this particular type of approach, a simple obligation would not hurt their business model or lots of other business models floating out there. It would simply break up the bundle for cable consumers.

MODERATOR GOLANT: Okay. I just wanted to add that the programming services they carry are all the broadcast services, ESPN, ESPN II, Disney, Toon, Food, Discovery, TLC, HGTV, Lifetime, Lifetime Movies, and Fox News, just so everyone knows what the story is. Tracy?

MR. WALDON: I'll make it brief because, like the rest of you, I am getting hungry here. But it appears that there are some costs that will go up under a voluntary mixed bundling system, although the magnitude is debatable.

If such a scheme was introduced, who should bear those additional costs? Just the customers who choose a la carte or all customers?

DR. COOPER: Well, and it is one of the points I was going to make. In all of the studies that you received from the cable industry and the broadcast industry, the assumption is that there is not one ounce of inefficient fat or market power abuse in the price the consumer pays today.

We suggest that there actually is a substantial amount of excess in there that might be competed away, precisely because the consumer has now -- you are now showing people the elasticity -- a better sense of the elasticity of demand for individual shows. So some of the really expensive shows might come down in cost.

You may believe that the only way to get a rookie football player to play hard is to give him $42 million, which is funded by -- primarily by TV revenues, but you know what? He may actually play harder for $1 million a year, because then he would need a longer career. Right?

So the point is that, by introducing -- It's important, and we mentioned this in our comments -- By introducing significant consumer sovereignty, by exposing programmers and cable operators to the real elasticity of demand for individual shows, you may in fact squeeze out lots of costs and end up with lower prices, not higher prices.

MODERATOR GOLANT: Thank you very, very much. It's been great. That ends our morning session. We have an hour and a half break, coming back at 2:30 where we will have our panel of distinguished economists present their views on the world of bundling and other economic theory. Thank you.

(Whereupon, the foregoing matter went off the record.)

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A F T E R N O O N   S E S S I O N

MR.   : Okay, welcome to the FCC. This is the afternoon session of the symposium on a la carte pricing in the cable and satellite industries sponsored by the Media Bureau. We've got a panel of academic economists. Tracy Waldon from the Media Bureau will be the moderator.

Let me briefly introduce our speakers. From MIT Sloan School, Eric Brynjolfsson. He is the Director of the Center of eBusiness there and co-author of a recent book on understanding the digital economy.

Our second speaker is Gregory Crawford, who is a professor at the Eller College of Business at the University of Arizona and has written extensively on issues in the cable television industry, including bundling.

Our third speaker is David Waterman who is an old friend of mine from graduate school. David is a professor in the Department of Telecommunications at Indiana University and has also written extensively on media issues and also cable television, including vertical integration issues and cable television programming.

Our last speaker is an old friend of

ours at the FCC, Steve Wildman. He is a professor of telecommunication studies at Michigan State University. He is the Director of The Quello Center for Telecommunication Management & Law, and also has examined the media and telecommunications issues and policy for many years.

So with those introductions, I will turn it over to Tracy.

MODERATOR WALDON: I thank you all for showing up for the afternoon session, and this afternoon will be quite a bit shorter than this morning. We plan on finishing up at 4:30.

I want to begin by asking our panelists about the current structure in the industry, the way programming is sold to consumers by cable firms. I am going to start with Professor Wildman who has done quite a bit of work.

Tell me, Professor Wildman, why is cable programming sold as a bundle? Why not individually?

MR. WILDMAN: Okay. You primed me ahead of time, and I am happy to respond to that question. I might mention that, as we were sitting here, Ken Ferree said that this morning's session was unusually lively and entertaining for an FCC session, and I think that maybe Tracy's objective in putting four economists together in a panel is to bring things back to normal.

In that spirit, I am happy to begin. I think Tracy called me, because in a book that Bruce Owen and I published in 1992 we introduced a simple model of bundling, program bundling, and why did that make sense.

Basically, the economists here will understand this. In fact, most people, I think, who have been around studying cable issues for a while will have seen the basic model, the bundling. It is a way to effectively price discriminate.

Now why is that? Well, if we assume that viewers differ in their valuations of different programs -- and I'll take two viewers, and you will see that most of the examples that are worked out in the literature are two good examples. An extension beyond that is what Eric has done more recently with Bacose (Phonetic) that looks at larger numbers of goods. But the basic illustration comes from two good models.

Assume we have John and Jan, and John prefers TBS and is willing to pay five bucks for it, and Jan prefers ESPN, is willing to pay two bucks for it. But turn that around, and we see that John was willing to pay two bucks for ESPN, and Jan is willing to pay five bucks for TBS. So they have the same valuations, but they are for different products.

Now if you imagined that a cable operator, or anybody selling programming, was selling each good individually, then you would ask yourself the question: If I am going to sell TBS to two people, I can charge at most two bucks. I'll get $4 out of that. If I sell it to one person, I'll get five bucks, charging a higher price. Therefore, I will sell to one person for five bucks.

So you have two products sold at five bucks each and generating revenue of $10. On the other hand, if we sell it as a bundle -- and you know, this is a contrived example, so they exactly balance each other off -- you know they value different programs. Each of them is willing to pay $7 for the bundle. So you sell it as a bundle, and you are getting back now $14 rather than 10, and that's the economic motivation for bundling.

It is a way of creating a homogeneity in the demand for the bundle that doesn't exist in the underlying demand for the individual products or the individual elements of the bundle. So it is artificially created in a sense, but it is natural in the sense that it arises in all sorts of marketplaces.

Now how do we look at that from an economic perspective? There is no -- You know, economists are criticized for saying on the one hand and on the other hand, and this is a case where we have plenty of hands.

It is easy to construct examples in which bundling will increase consumer welfare and it will increase profits as well. Total surplus goes up. It is also easy to construct examples in which profits will go up, consumer surplus will go down, and in which total surplus goes up. In fact, that is a fairly common result, to find that total surplus goes up. The combination of profits or total benefits created above cost, the combination of profits and consumer surplus goes up. The more that goes to the producer than to the consumer.

So the consumer's share may actually decline, although it is not necessarily an outcome. You can also find situations in which you may actually find a decrease in welfare from bundling.

Economists, by and large, tend to view price discrimination as something that tends to promote efficiency, because you are picking up somebody with a marginal valuation. In this case, it is two people wanting to pay two bucks that wouldn't have taken a product before. They are now buying something, and you are getting a transaction taking place that wouldn't have occurred otherwise.

So in most cases, although not all, economists tend to think that the price discrimination, whether directly or indirectly in this form, tends to increase welfare and is a good thing.

Now it is important to note in this example that neither consumer is paying for something that they didn't want. If you offered the two components of the bundle by themselves at five bucks, of course, they would say I don't want the other one; I'm not willing to pay five bucks for the one I am only going to pay two for.

On the other hand, when you say are you willing to pay that incremental extra two bucks for it? Yes, we do want that. So people are getting things that they do want.

Now it is possible -- and, of course,

the real world is more complicated than that, and most people don't watch all the services available in their basic or expanded basic cable package. So some people probably don't want everything that is there. But nevertheless, you are still aggregating over a larger number of heterogeneous consumers, and the basic logic is still there.

You aren't paying for something you don't want, although something you may not want is there, but it is a way to bring people together, similar to a newspaper where my wife never reads sports, I never read the Living section. Nevertheless, we both want the paper, and given the cost of distributing it individually, the sections individually, we are better off taking the package.

Things that go beyond the basic bundle are questions about what this might do to programming quality, and the work that David and I have done in the past -- and you go back farther, Bridger Mitchell (Phonetic) and Bob Crandall (Phonetic) really modeled, although they didn't exploit them -- clear indicate that the larger the audience available or the revenues available for a programming service, the greater the competitive incentive to invest in the quality of the program.

So to the extent that the bundling does increase the total revenue, then you would expect that to be reflected in better quality programming. How much of that goes to consumers, how much goes to producers and distributors is another question, but there should be a positive effect on programming quality.

It is important also to note, I think, that the models that we are looking at, for the most part, are not models of competitive situations. What Owen and I did and what most of the work that has been done since largely deals with monopoly bundlers.

The work on what does it mean to compete in bundles and what does that produce really is relatively undeveloped.

I think I'll just stop right there.

MODERATOR WALDON: One of the interesting things I notice in the U.S. industry is that all firms appear to offer bundles. No firm is offering a la carte channels. I wonder, why do we see that? Why is it that competitors, who have had to enter in and compete against an incumbent with a substantial market share, haven't tried this newfangled thing?

I'm wondering if maybe Eric has some thoughts on this, given some of your work.

MR. BRYNJOLFSSON: Sure. Let me say first, I agree very much with what Steve said in a very nice summary of things. I want to highlight a special characteristic of cable TV, which is that what they are selling are information goods. These are goods that have a lower, virtually zero, marginal cost but a high fixed cost.

In the work we have done, a lot of it with my colleague, Janis Bacose (Phonetic), we really focused on these information goods, and we find that bundling of information goods is really very different than bundling of other kinds of goods.

I heard some discussion this morning about supermarkets and what-not. The real difference comes from the fact that, when you sell an information good, if you provide an additional channel or something, there is very little real cost to doing that; whereas, if you provide carrots in addition to cucumbers, there is a real cost if somebody doesn't like one or the other of those vegetables.

As a result, the cost side of providing

a large number of channels is very low, but the benefit comes mainly from, I think, these price discrimination features that Steve highlighted; and those price discrimination aspects become more and more powerful, the bigger the bundle is.

As a result, you are able to reach consumers with products that normally would be priced out of the market by offering them a bundle. Therefore, the total pie does get much bigger.

I wanted to sharpen some of the things that Steven said and say that, while you can construct examples where things go in different directions, when you work with very large bundles, as a lot of my work has focused on, there tends to be an overwhelming preponderance of cases where the total welfare grows -- the total size of the pie grows, but the share going to consumers tends to get smaller, and the share going to producers tends to get larger.

So depending on how you want to weight things, if you want to take a strictly consumer point of view, this could actually be a bad thing. My own work tends to treat it in a more balanced way and look at the total side. But to answer your question directly, with any kind of information goods it tends to be much more profitable and you tend to get much more market share if you offer a large bundle.

MODERATOR WALDON: We have heard a lot of sort of talk about theory and how it might go this way or it might go that way. Actually, I am wondering which way does it really go? Professor Crawford has done some work on that, and I'd like to hear what you are finding and what you find difficult about measuring things in this industry.

MR. CRAWFORD: Thank you for the enviable task of saying which way it goes. So I think that question is a very difficult question, and in my comments I am going to try to highlight in part why it is so difficult.

The key elements, in my view, of figuring out -- A lot of questions have been raised this morning about, well, what will the world look like if we went an a la carte -- either a mixed or a pure a la carte kind of world?

The key elements, in my mind, to answer that question are the nature of demand and cost, and in particular demand by consumers for the individual networks offered by a cable system, as well as advertising demand for eyeballs for the households that watch those networks. Then on the cost side, of course, there's the affiliate fees to the program networks as well as any actual costs from unbundling to the system.

So much of my work has been focused on the consumer side, the retail side, trying to estimate -- I have done a fair bit of work estimating demand for bundles, but it is a far cry estimating demand for bundles from backing out the demand for the individual networks that comprise those bundles.

In part, as you can imagine, there is a fairly rich array of networks offered on cable systems, and those networks do vary quite a bit. But you are still trying to tease out 40 or 50 effects from purchases of a single good.

So what do you do? So I would actually -- So in some of my work I have suggestive results, and the results that I have found coincide with the implications suggested by Steven and Eric, that in what I have found, if you estimate demand for bundles and then you calibrate a model which makes certain assumptions -- so we are relying on more assumptions here in getting the specific answers -- you do find that, in fact, consumers are worse off, firms are better off, and the gains to firms outweigh the losses to consumers.

But it is a far cry from doing simulations of the sort that I just described and actually going and actually estimating specific demand for ESPN, say, and the specific demand for TBS.

So in some of the earlier comments that were raised this morning by industry participants, there was the idea that systems should be encouraged or at least be given the option to experiment, to try offering alternative bundles.

From an academic economist's perspective, that is wonderful. That is exactly the kind of data that we would need to actually figure out what is consumer demand for each of these networks, and that would allow one to effectively begin to answer or begin to address this key question of what would happen in these alternative scenarios.

So just to conclude, you know, I find strong evidence of the general theoretical effect, but when you get to specific magnitudes, which is what really matters if you are going to take it in a policy direction, there is still more that needs to be done.

MODERATOR WALDON: Professor Waterman, I want to ask you about quality of the programming. Professor Wildman has suggested that the ability to gain large amounts of revenue through bundling leads to improvements in quality. What are your thoughts on that?

MR. WATERMAN: Well, I can answer at least indirectly. I'd like to express my outrage that so many people have left after the morning session. They knew the economists were coming.

Well, yes, I think program quality is something important, and there are some significant effects about this. Let me address that by picking up on what I think is another reason for bundling that goes on, which I think perhaps even has a more important empirical effect than some of the things that my colleagues have articulately expressed.

That is the relationship between advertising and affiliate fees. There's kind of a difference in incentives of the program suppliers and of the cable operators that I think induces a lot of the bundling to occur.

Cable programming networks are like magazines. They get money from advertisers, and they get money from subscribers. The cable operators pay those fees back to the program suppliers, but from the cable operators' perspective, they don't care about the advertising. They only care about the incremental value to attracting more subscribers who give them cash on a monthly basis for subscribing.

Because of this kind of asymmetry, there has been -- A long time, there has been a conflict between what the cable programmers want and what the program -- what the cable operators would like to provide, because at the upstream level the contracts often require or typically require that the program services be carried on certain tiers, like a basic tier, like ESPN will say it has to be in a lower tier or else we have to get a far higher affiliate fee.

The reason that they are doing that is that they get a large amount -- perhaps the majority as a whole in the cable industry gets a majority of their income from advertising. So even though, as Mr. Hooks said and some others said, that they would like to create, you know, a sports tier, for example, and ESPN on it, this would have a very detrimental effect to ESPN; because when you put it on a digital tier, the number of subscribers -- the numbers of viewers goes down, and that affects their advertising rates substantially.

So they write the contracts to basically prevent the cable operators from doing this kind of activity. So all these analog channels basically write their contracts in ways that the operators are pretty much forced to put them into bundles. There's a lot of other reasons for bundling this.

This probably has a pretty -- (END OF TAPE 3/SIDE1)

START TAPE 3/SIDE2) -- the advertising revenues of ESPN, because advertisers want networks that blanket the U.S. and that reach at least, you know, a very high percentage of the markets in the U.S. But if you start putting these on digital tiers, that is going to shrink.

We did a study -- I think it was published in 1999 -- that shows that there is -- Actually, if you restrict, say -- If you cut the audience of a cable network by 10 percent, that not only reduces their advertising revenues by that 10 percent, but they suffer a 13 percent additional decline in the rates that they are able to charge advertisers, which means they have a 23 percent drop of their advertising income.

So I think that, if you -- You know, when you move to an a la carte system, that one of the very substantial effects is that you would substantially reduce the advertising revenues coming back to cable networks, and a lot of that money would go into broadcast and whatever.

So the total pie would decline. I think that that is one of the reasons that the programmers, you know, are so worried, really, about the a la carte.

There are some other strategic elements going on in terms of why the programmers require bundles and do some of the kind of things that Mr. Hooks talked about, which are very interesting. There's a whole strategy of network entry and how to pry your networks into the market. One of the reasons they tie them, I think, is to facilitate that.

I have already talked too long, but I will just summarize by saying now that what this would do is -- tie back to the quality issue -- is that the revenues of the networks would go substantially down probably, because -- if there was a substantial amount of a la carte pricing, and that would tend to lower the quality of the networks, because they would have somewhat less money to pay for programming, and it could cause some exit and whatever.

There are some good things about a la carte pricing that I didn't get to. So I don't want to leave the impression I am just hitting whole hog against it, but this advertising factor is something pretty significant, I think.

MODERATOR WALDON: Great. We will talk about the positives of a la carte later. I encourage you to keep letting us know about that.

One of the suggestions that -- Actually, I should ask, does anyone else want to chime in with more?

MR. : I would just follow with one thing in terms of the advertising, that the advertising does affect the rates that subscribers pay. If you think about the negotiation between a cable network and a cable system operator, and you are asking what is the nature of that negotiation -- and there's added value that is created by that incremental network.

What you are negotiating in negotiating

a license fee that is paid by the operator is the division of that incremental value. So if you think of it as only the subscriber fees -- and we tend to -- you know, economists tend to conveniently assume bargaining where you divide that in half.

So suppose there's 10 cents a month there that is actually added in incremental value. Then the operator would pay -- would sort of collect half of that and pay only five cents to the cable channel.

All right. Now we add another 10 cents in advertising, and you are dividing that as incremental value that is created as well. Five cents of that goes back to the operator, and that offsets part of the rate. So the rate in this example I just concocted becomes zero, but you do end up with lower rates paid, because there's advertising involved.

Now there is a study that Dertusos (Phonetic) and I did a number of years ago that pretty clearly demonstrated that. So when we are talking about the advertising consequences, it is also important to note that there is a rate consequence as well.

MODERATOR WALDON: One of the proposals that has been advanced is the concept of themed tiers. As we have just talked about, one of the benefits that firms find from bundling is combining together consumers with different preferences.

Do themed tiers have an advantage when they are themed, meaning offering similar types of programming, or do some of the benefits of bundling together the channels disappear in that instance?

I will throw it open to anyone who wants to tackle that one.

MR. : Yes, I'm happy to say a little bit about it. Clustering together similar goods makes a lot of sense when there is a marginal cost to having a product that you don't like in the bundle. In the case of cable TV, I don't think that is really an important factor. So that benefit doesn't exist.

On the other hand, there is a cost that you alluded to in your question, which is that much of the power from bundling comes from putting together a heterogeneous -- goods with heterogeneous demands.

In the example that Steve gave at the beginning, one consumer had a value of $5. The other one had a value of $2, and they were exactly opposite. So that was the case where bundling worked extremely well in terms of increasing the total market.

I want to emphasize that it is not necessary for the goods to be -- the values to be negatively correlated. Bundling works even if they are uncorrelated or even if they are positively correlated, and this is -- I just want to stress this point, because it is a common misconception in a lot of the literature, in several textbooks I've read, and some of the background reading that you gave us, that bundling only works if there is this negative correlation.

Steve happened to use an example of that. That said, bundling does tend to be more effective when the goods are not highly correlated with one another. Therefore, these themed tiers tend to make the benefits of bundling less important and, therefore, would tend to not expand the market as much.

That can have costs on a couple of levels. One is this idea that fewer marginal consumers would be enticed -- More people would be priced out of the market, in all likelihood, with the themed tiers.

Secondly, and this is a more difficult benefit to quantify, one of the advantages that was alluded to was having a variety of different viewpoints and a variety of different types of programs that people are exposed to. Naturally, if you constrain the bundles to not have these different types of viewpoints or types of entertainment, you are reducing that sort of benefit as well.

MR. : Just one comment about that. I mean, I think the gentleman from Insight mentioned this morning, cable operators do offer themed tiers off of their digital offerings. So they will group things together and sell them, and it is a good marketing ploy to do that.

The reason that they do that just for the digital networks is that most of those networks don't make much of their money off advertising, because they have such limited audiences that they primarily rely on fees. At least, I think that that is a fair statement of the general rule.

So it is good marketing to offer themed tiers or a sports package or something like that. I think it is true that you still also can take advantage of this value averaging effect within a group of five or six sports networks, you know, because a minor sports network some people won't want, and some people want another, and you still can get that kind of advantage, you know, and still have the marketing advantage of going after the nuts for particular types of programming.

MR. : So I would just say that I think I agree with everything they both said, but just to refine one point, which is that it matters a great deal if the themed tiers are offered only exclusively as a themed tier or if they are also part of a larger bundle.

If they are offered as part of a larger bundle, there will still be some of this averaging effect in principal themed tiers, the same way you would get for individual networks. Whereas, if they are not, then the beneficial to the system's effect of the bundling would be less, and significantly, if they were just offered separately.

MODERATOR WALDON: Well, we are moving along quickly here. But let's look at pure a la carte then. Now while that isn't exactly what anyone has been suggesting, as economists we always like these sort of pure models that we can pick apart and see how things really work.

So I would like to start with one of the very common complaints about a pure a la carte world is that diversity would suffer, that niche networks would not get started, that possibly existing niche networks would disappear.

How do you evaluate those perceptions? is that what we think would happen?

MR. : I can address that, at least from one perspective. The models that we use tend to be fairly static models where you are given a set of programs. I mean they are identified. You are given an operator, and the operator -- and you are given consumer demands for the program, and then you create your bundles or not and what is, to me, the sort of my implicitly, if not explicitly stated so, perfect information models.

On the other hand, if we are looking at what an operator is doing in bringing in a new network -- so the bundle or the set of networks that is available changes continuously over time. I don't have the data on the number of new networks that come in every year, but what you are having the operator do is behave as an intermediary. It is the operator's job to be like a retailer who is assessing local consumer demand.

Even though Wal-Mart is fairly homogeneous across the country, there's some variability, nevertheless, in what Wal-mart offers from one market to the other, and you would expect that to be the case also for cable operators.

If we are -- Suppose we go to a world that is purely a la carte then, especially with the mandated a la carte. Then the notion that you might stock something to allow somebody to try it -- and I know that this morning Mark Cooper said, well, nobody is forced to try something. Right? That when you go into a supermarket you don't have to take something off the shelf.

Well, in reality, you are not forced to actually sample a cable network that is put available, but it is made available in a sense by the operator saying the opportunity cost of the time I have or the time I am using for something else is less than what I think is the long term value of the programming I am putting out there.

Whether the consumer would take that risk as opposed to the operator taking that risk is whether you think the consumer can do as good a job in evaluating what the network promoting itself might say it is going to be as opposed to the operator looking at the larger marketplace and saying is there a market for this.

Now my inclination is to say that, you know, if we were mandating a la carte, then we would sort of be seriously intervening or interfering with the ability of the operator to behave as a retailer in terms of assessing and aggregating demand.

MODERATOR WALDON: Would anybody else --

MR. : You are talking about pure a la carte?

MODERATOR WALDON: Yes. Would we see harm in this, or not?

MR. : Well, I think that very few people would probably be in favor, actually, of having a pure a la carte system.

First, I would say, you know, I am basically very sympathetic to the objectives, for example, expressed by the Consumer Union people about people being able to select the programming that they want.

There are some evident advantages to

some people from having even a mandatory a la carte system. People who have very intense demands for particular programs and very little for other stuff could probably end up paying less, because even though they would pay a significant a la carte price for the programs they want, they wouldn't buy a lot of other stuff if they don't want it all.

It would also satisfy the complaints about people who are getting programs that they don't want, that they feel is indecent or whatever. You can't help but be sympathetic to those situations. But I think probably the overall effect of a mandatory a la carte system would really be pretty disastrous.

I think, first of all, it would have a very negative effect on the advertising market, because advertisers would no longer have very much demand to reach such small audiences. What that mean, they would be -- networks would be more dependent on their affiliate fees, but they couldn't begin to raise -- They can't just raise their affiliate fees. They have already raised them what they can.

They would refocus their programs to try to appeal even more to intense groups. So the programming content would change, and also, you know, there are these cost issues involved that we heard about involving the set-top boxes and stuff like this.

I am not an expert in this at all, but to the extent that there are costs by the cable operators to do these kind of things, I mean, they are obviously going to significantly affect the -- significantly affect the rates or the amount of money they are able to get. So the program quality would diminish.

I think, clearly, what would happen is it would tend to disadvantage networks with relatively low demand, of which there are a large number. The reason for that is that, because of the transactions cost, you know, of selling each network on an a la carte basis, those networks that don't have a lot of value in the market now would see their actual prices to consumers relatively very high; because there are going to have to be big transactions mark-up sort of to sell them.

So people would tend to gravitate, I think, at any price, a reasonable price we could expect, toward the larger, more commonly supplied networks, the better established networks. So the more marginal networks, particularly those that are more dependent on advertising, would tend to be forced out of the market.

So I think, if we had a -- We probably would see quite a different looking landscape to cable if we had a mandatory a la carte. There is no guaranty that even the people in the long run would benefit who just want one, you know, arch channel; because the overall effects, the cumulative effects in the advertising market, everything working it back through everybody's economies of scale and operation being atrophied and everything like that, you could really end up with a mess.

MR. : I would like to weigh in on that as well. I pretty much agree with my colleagues here. I don't think there is that much of a technology issue in providing the a la carte. I think that can be done. But I think there are four reasons why it might not be such a good idea.

First off, it has to be understood that, you know, the marginal cost of delivering these products is very low. I think there is a -- I know there is a presumption, having spoken to my cab driver and listened to some of the (inaudible) and others, that people assume that if you've got 500 channels and they are offered a la carte, you know, then each channel will only cost 1/500th as much as the bundle or maybe not quite that extreme, but they think they would cost a lot less.

The reality is that the equilibrium pricing for a single channel might be a lot closer to the price for the entire bundle than it is to a fraction of that. So you may end up -- You know, if you look at other places where some of this has happened like, say, MicroSoft Office, when they offer the components, the components cost almost as much as the bundle itself. I imagine we see something similar with cable TV.

So it wouldn't necessarily be much of a savings, if at all.

Secondly, there would be some additional transaction costs, although I don't really think that that is that big a deal. I think that that could probably be handled.

Thirdly, for reasons that we've mentioned earlier, a bundle tends to reach a broader audience than the same content provided a la carte. This has been analyzed in great depth, that the quantity sold tends to go up and, therefore, a la carte pricing is likely to lead to smaller overall audience. That has an effect on things like advertising, as David was pointing out, and just translated quite directly into welfare.

Just to highlight this low marginal cost point again, when a good has close to zero marginal cost, the economically efficient thing from an economy-wide standpoint is to make it available to everybody who has a value of it greater than zero.

So to the extent that some people are priced out of the market by a positive price, that is a detriment to social welfare, and that tends to happen to a greater extent when things are priced a la carte than when the price is bundled.

Then fourthly, there is this variety point. Steve in his opening comments pointed out that bundles tend to generate more revenue and, therefore, you tend to have more funds available for obscure products.

It is actually even more extreme than that. If you do the analysis that Janis Bacose (Phonetic) and I have done, disproportionately hurt are the small, not widely watched content channels. When you go to a la carte, their subscriptions and their revenues fall disproportionately. Conversely, when you add them as part of a bundle, they are the ones that benefit the most.

So going to a la carte is going to disproportionately reduce the amount of product variety and obscure channels or viewpoints that are available, as compared to bundles.

There is an offsetting point that we haven't really touched on too much, which is what we have mostly been discussing is the static effects of a bundle versus a la carte. Things get much more complicated, but also in many ways much more interesting when you consider the dynamic effects of what happens over time.

One of the concerns I would have about bundling, on the other side of it, is that it tends to promote and entrench the monopoly power of the cable provider. They have an easier time fending off entrants when they have a large bundle than when they are offering lots of small products.

Over time, that can lead to other sorts of costs to society in terms of innovation or just entrenched monopoly power.

MR. : I would actually like to follow up on one of the points Eric made about pricing in an a la carte world versus a bundled world, and to draw a distinction again between if it is a pure a la carte or if it is a mixed a la carte with a bundle.

I think, if you force networks to offer exclusively a la carte, then they will in essence be pricing to everyone for whom there is demand for their service, and that price will be what it is. It is surely going to be higher on a per channel basis, like Eric said, than it would be as a share of the bundle price. But I think we should be a little bit careful if we talk about mixed bundling where the bundle is also available in conjunction with a la carte.

If the system is still maintaining control of both of those prices, it is quite plausible to me that that a la carte price for individual networks would be extremely high, and indeed much higher than it would be on a pure a la carte basis. Clearly, it is going to be bounded above by the bundle price, but it could get pretty close.

MR. : That's right.

MR. : The example Eric used, one in which the sum of the a la carte prices probably dramatically exceeds the bundle price, from looking at MicroSoft Office.

MR. : That is what you would expect in equilibrium, I think, you know. I don't know whether the people who are encouraging it, you know, also have in mind some kind of price controls, because without that, you are likely to see that the individual components have prices that are close to the cost of the bundle itself.

MR. : And to answer that question in detail, again we have to get back to the demand for these individual networks, and I think that is the source of great uncertainty in my mind, anything that we could do to promote gathering information in that dimension would be most welcome.

MR. : I agree with that. My concern, though, is that we are sort of enforcing a static visualization with that demand (inaudible). If you look at -- You know, ESPN is very different now than what started out, or we recently got Spike TV that was converted from some other prior thing. It is now the man's network which is the opposite. You know, it wasn't that six months ago.

One of the concerns I have is you are

trying to create bundles. So we are going to have these themed bundles. Are you locking programmers in into a theme? And do we -- How do we allow for evolution in the system, because there has been a lot of evolution.

You look at somebody like USA which started out competing with ESPN, and is now closer to, I suppose, Oxygen. It certainly doesn't have anything to do with ESPN. I don't know how we deal with those things, those dynamics.

MR. : I think -- In addressing your question, I think the place where the competition is most urgently needed is at the level of competing cable providers, and that would be a way -- Rather than, I think, tinkering with the bundling or unbundling a la carte, focusing more squarely on the competition among cable providers is likely to have a lot more benefits for consumers as well as provide a mechanism for new content to get entry.

MR. : Well, I would like to raise a question more specifically about entry, you know, of small networks in some of the points that were made this morning, for example, by Ms. Laybourne from the Oxygen channel, which is that it is true that if you have a program service that basically hardly anyone knows about -- I mean, it is easy to imagine a service that everyone would love, once it was up and running, but that people don't know about or are not familiar with in this kind of thing. You want to have a system that facilitates the possibility of those networks being able to enter the market and being put in front of consumers.

It actually makes sense, a lot of sense, for a program supplier who has a network like that to take every strategic device that they can think of to try to get cable operators to take that network and put it in front of people, even at a substantial loss, you know, for a period of time.

I think that one of the ways that they do that was described by Mr. Hooks this morning. They bundle, and they say, you know, you can have this network for free if you take my well established network which I know that you need.

There are some good economic models, you know, to describe why that can be a very effective strategic behavior in the market to get networks in.

There is a downside to that, which is

that independents -- and I think we see some of that in the testimony this morning, too -- Independent networks who don't have any corporate connection with a well established big network or some of the Big Five, as they were termed, have a harder time entering, because they can't use strategies like this tying.

So if you got rid of the tying and the bundling, you know, it would tend to relatively advantage the independent networks relative to the ones that are promoted by the Big Five, but I think the overall effect would probably be less entry of new networks altogether, even though at a relatively advantage to the independents if you took away these strategic devices that they have, that the overall effect would be negative; because you wouldn't be able to get the type of investments, the sort of coordination of getting all the MSOs to carry it and make commitments for a period of time or being able to force the MSOs to carry networks that they don't want to carry that are in the circumstance like that.

You would probably get less experimentation and less overall expansion of diversity, even though that probably you get more concentration of ownership in programming due to the bundling situation.

MR. : I agree with David entirely. I'll maybe expand on that just a bit. What I was thinking about, these tying arrangements, whether a broadcast or a negotiated retransmission consent demanding a broadcast network that do you carry our cable channels well, or it is the bundling of CNN Headline News along with CNN and so on.

These are non-price arrangements, and why can't you have a price that is equivalent in a world with no transaction costs? There is no reason why you couldn't. I think, if you just look at the various arrangements in this industry, the fact that you are constantly relying on these bundled arrangements is the suggestion that it is very difficult to handle the complexities of the negotiation through price alone.

It does create a disadvantage for somebody who doesn't have something to bundle with. On the other hand, it doesn't make the cost, the transaction cost, go away. So it does bias the source of the entry. On the other hand, it does make entry easy.

So I would agree with David. I think if you look at the way networks are priced, the fact that they are sold on the basis of per subscriber -- you are paying 50 cents per subscriber per month or whatever it may be -- in reality that is an inefficient pricing system, because it becomes a marginal cost to the system operator. You raise your price, and the total number of subscribers goes down.

It would be better if you could work out a fixed fee, and you could charge -- and actually, you are charging your subscribers a fixed fee, but a fixed fee between the network and the cable system operator. But the inability to do that forces you back on a more inefficient mechanism.

These are inefficiencies we have to live with, but it just reflects sort of the nature of the transaction costs that are involved in this process.

MODERATOR WALDON: I want to put all of you now in the position of an FCC economist, which means we have a situation where Congress has passed a law. You may not like the economics behind it, but they have passed it, and now you have to implement it.

Suppose, for an instance, that Congress mandates that you somehow force cable companies to offer mixed bundles or a combination of their existing tier situation as well as channels on an individual basis.

So I have two questions. One, how do you design regulations to make sure it is effective and consumers really have a choice; and two, how do you design those regulations so, if you believe there is the potential for harms due to them, you can at least minimize those?

Now you see why being an FCC economist is so difficult.

MR. : Well, if nobody is going to talk, I'll -- I think that -- In the first place, I think if you just required this, nothing much would happen. As Eric said and as makes a lot of economic sense, what the operators would do is they would just price the individual networks in such a way, relatively high, that very few people would take them.

I mean, you only have a few cases where you have people who are, you know, fanatics for one type of programming who would really benefit from this kind of thing, and people would say, well, look, if I accumulate three -- you know, if I just take three networks, I can get 45 for the same price. So I'm just going to take the bundle.

For one thing, unless you restricted the program suppliers from bundling upstream, the cable operators wouldn't do anything, because they would keep doing the same thing. But quite apart from that, they would just keep those prices really high, and some people -- They would keep them high enough to where their actual benefit, if somebody did take these a la carte channels, would be enough to cover their costs, presumably. But I think it would be a very marginal thing, and not very much would happen.

Then the big problem for the FCC is if then people look at what they are doing and saying, look, this is not realistic; you guys have to have some kind of rules to force the a la carte prices down to reasonable levels.

Then it is rate regulation all over again. There is no way that I can imagine how you can come up with some kind of rules. Maybe you guys have thought about some that would regulate these prices and a la carte prices for programs that would be reasonable, and there would be all sorts of controversy going on about that.

The program suppliers -- The operators would come back and say, look, the reason we have these rates so high is that, if we lowered them a little bit, a lot more people would buy it. Then the advertising rates would -- Then the advertising revenues would fall, and they would raise their affiliate fees.

You would get these kind of cumulative arguments of what the end result would be if they lowered their prices, and I think you would just be into the biggest mess that I can imagine.

MR. : It would be a mess that we have seen before. I mean, the danger of rate regulation is, of course, you can't control what they put on their network. So no matter -- Even if you knew the right price today, you know, the efficient price for an a la carte, and you could impose that, networks would have every incentive to just reduce the quality of their programming until that price was the optimal price for the quality that they are going to offer.

So you know, I think it is a really difficult -- It's a difficult problem. I hate to not have an answer, but the point being I don't think rate regulation is the answer.

MR. : It does suggest a -- As opposed to just saying there's a cap on rates, and not just in media but in other products as well -- There is work by Michael Darby (Phonetic) in the 1980s showing that the effects of mixing price controls with a general reduction of the quality of products who were subject to price control.

You can get away from that if, instead of regulating the levels, you regulate the ratios of the components of a bundle. So that would be the least -- It would be a less inefficient form.

The problem is every bundle is different. You change the content, and suddenly the appropriate relationship has changed, and I don't know how you manage the possibly keep up.

It was suggested this morning that you might do experiments. At least, if you did experiments, you would have a better empirical base to begin with. The problem is, you know, the nature of experiment is you start small. So by definition for this kind of experiment, you won't have these longer term, backward effects of people responding to -- you know, total effects on total advertising dollars, total effects on quality. So those effects really can't be addressed in the experiment.

There are so many hands here. I mean, you don't have a sufficiently multi-handed economist to deal with all of this. I don't know if anybody else has anymore comments to offer.

MR.   : Well, let me just -- I think there is actually an enormous amount of agreement here. I mean, it is not a matter of different hands, different perspectives. I think that I agree with what my three colleagues have said before me, that if all you did was mandate a la carte, effectively mix bundling in addition to the existing bundles, the equilibrium price would undoubtedly be that the components would be offered at very high prices relative to the bundle, almost equal to the bundle price.

We have analyzed this, and this is what the optimal price is from the perspective of the seller. In fact, they make slightly more money from that then if they just only are constrained to offering the pure bundle. So I am not sure that they should be resisting it in that sense, except for the extra transaction costs.

So that would be the outcome. I don't know that -- In fact, consumers would not be made better off by that in general, because the prices for the components would be very high.

Now if you then said, okay, well, that's not good. If we want to go further and start forcing those component prices to be down, I think you get into such a morass that has been touched on that it wouldn't necessarily serve the interests of consumers, producers or anybody to try to have some agency decide all the literally tens of thousands of price combinations that would be required.

It is an NP complete problem where you've got a common internal explosion of possible price combinations that would need to be regulated, and then dynamically updated a new content became available. I don't see that as being a path that seems very appealing to anyone.

MR. : It goes beyond that. You know, even if you manage to regulate just the ratios of prices -- and I can guaranty you, if I am a cable operator, I am going to start fiddling around with the components of the bundles until it becomes effectively not a constraint, because there would be different degrees of substitutability among the elements.

So you can't just regulate even price ratios. You also have to regulate the components of the bundles as well.

MR. : Just very briefly, I think that out of the Booz Allen study, for example, presented this morning -- I mean I think that is a wild exaggeration, you know. What would happen, because nothing would happen unless you got into actual interference in making them lower the prices. Then some of the things they are talking about start to get realistic, but otherwise, look, the programmers don't want it, and the cable operators don't want it. I guaranty you, they will figure out ways so that nothing happens.

This is pretty much what they did with rate regulation.

MODERATOR WALDON: Well, I guess I got a big job ahead of me.

MR. : Well, I would add one other thing. You know, you asked for more concrete advice. You should look for a way to design this in such a way that the bundles themselves don't displace too many programs that might have been there on the channels otherwise.

In other words, do it in such a way that you don't end up with a net reduction in the total offerings that are there.

MR. : There is one relatively -- perhaps relatively less painful way to do it, which is to not require the operators to do anything, but to change the nature of the contracts of the programmers; because as we mentioned before, the programmers do a lot of tying. They bundle things together, and sometimes they do it in a way that you just have to take the small networks.

So -- and I'm not advocating to do this, but if you just prohibited the program suppliers from any kinds of tying contracts, what you would do is you would tend to free up the operators to offer a la carte services where they were relatively profitable for them to do so.

Now you recall the Canadians talked this morning. They make a profit by offering some of these themed channels for $2.49 off a digital channel. That is a demonstration of something that is an economic reality, which is that, you know, even though the dominant effect for the advantage of the bundling, incentive to bundle, is this value averaging effect that we talked about, it is also true that it can be profitable for them to do mixed bundling if costs are low enough.

The Canadians are an example of how that can happen. I mean, just very briefly, if you have ten channels costing $10, and the average valuation is about a dollar a piece, but you know, it is $2 for one person and 50 cents for another, well, you can get more money by averaging those together.

Say you got one person who speaks French only, and then one of those channels is French. That person will pay $8 for the French channel and nothing for the others. Then you can make a profit by charging $8 for the French channel or the bundle for $10. That is exactly what would tend to happen.

You can't do that now very effectively except for the digital channels, because their cable program suppliers in their contracts bundle things together, and they require you to put them on different tiers.

So you wouldn't be able to carry out the regulation that you are talking about unless you address what the cable program suppliers did.

That would be one way to do it, but you would have all these entry -- You would have these effects of diminishing ability for them to start new networks and a lot of stuff would go on.

There would be some advantages to forcing the program suppliers to unbundle, because there are strategic effects, some of which are probably anti-competitive uncertain interpretations. I mean, if you are entering the market and you have a PET (Phonetic) channel and an independent supplier has a PET channel, and you also have TBS and you say, if you want TBS, you got to carry my PET channel, you can force that other PET channel out of business.

There is a good model for how you can do that, because they can't realize their economies of scale, and then people won't enter. So you would have some benefits of restricting the pricing practices of umpteen program suppliers, even though I would maintain that the net effects would probably be profoundly negative if you did that.

MODERATOR WALDON: Would your views on this differ if, instead of requiring a la carte, instead Congress asked us to allow themed tiers of a particular variety, whether it be a family friendly tier or a sports tier, or do the same concerns really hold there?

MR.   : I think -- Well, you bring up especially the family friendly tier. We are getting into political issues as well as economic issues. On the political side -- I mean, I don't see any way to sort of import the knowledge of an economist into the political.

If you are really saying that there is content -- and we have regulation of broadcast networks, the family hours and things like that, and children's programming. That is a cultural and a political question, and I think that is to be decided in a cultural and political arena.

So when it comes to that kind of tier, I don't have the expertise or not even the inclination to try to disagree with that in terms of the non-economic components.

When it does come to the themed tiers, though, you have to ask then who identifies the themes, and is there any objective way, some neutral mechanism, by which you can say, yes, this constitutes a theme. Maybe when you are looking at Greg's estimates in terms of cross-elasticities, you are going to identify things that go together.

You do lose some of the benefits of bundling we have been talking about when you start creating these tiers. So that is a concern.

The bigger concern I would have, though, is that long term how do you ensure that the things that are in the themed tiers stay themed, and what if tastes change over time. How do you identify the new themes? It's sort of imposing regulators in a dynamic marketplace that's caused some adjusting, and it seems to me, there's just a lot of costs associated with that.

MR. : So actually, I would like to follow up on something that David said earlier, which was as a recommendation to allow a la carte. So as I learned this morning, many of the contracts between program networks and distributors require that the network be carried on the most widely available tier.

Now abstracting from assuming this would only be for digital subscribers, but -- so we could abstract from the cost to the system of offering a la carte. I would actually like to ask my colleagues, is it possible that cable systems produce too many networks or too much quality?

It is clear that they are going to

provide more than would be provided in an a la carte basis, and if that is the case -- and it seems to me that is at least a possibility -- then -- and Mr. Hooks mentioned that possibility earlier today when he said he would like to offer in one of his markets the opportunity to drop ESPN and offer the bundle at a lower price, which suggests at least he perceives that customers in his market would prefer not to pay for ESPN.

So it would seem to me that allowing systems the flexibility to offer a la carte, should they so choose, might be something to consider.

MR.   :   I guess, you know, I listened to Mr. Hooks, and I think he may have a case for his market. On the other hand, we have to be careful when we are looking at this, because there are transaction costs, that markets are always imperfect. So the fact that we can identify imperfections in the way things work doesn't mean that necessarily we can come up with an efficiency improving correction of those. That is an important caveat.

The question about whether or not we have too much quality -- that's a good one. I don't know any way to address that question. That is, you can't assume that necessarily more quality is always better, because price goes along with quality. There a cost of producing quality. At the margin, are we getting more than the opportunity costs of producing that? I don't know. I don't know how to answer that.

I think that is a challenge that perhaps is beyond the tools we have available, really.

MR. : I'm not sure I think about this quite the right way, but if I understand it correctly, I mean, the cost for ESPN or whatever is all a fixed cost up front. So I mean, there are various price discrimination reasons or what-not why it might have a higher price, but there is no intrinsic economic cost reason why the price -- why quality and price have to be correlated on a cost basis.

It may be that they choose to price it that way in order to extract more money. So it is not clear to me that there is any real cost in that dimension, once it's been produced, in making it available as widely as possible, seems to me. Given that it has been produced, you want it to be made available as widely as possible.

Let me just also briefly just touch on what you raised earlier about the themed tiers, the themed groups. Most of the work that I think most have been thinking about have been under the assumption that the lowest value you could have for a good is zero. But you could have a negative value for a good, you know, because it is offensive to you or some other reason. Then a lot of this analysis and assumptions goes away.

One way of dealing with those goods that could have, you know -- just call it negative value because they are offensive or whatever reason -- would be themed tiers, but that seems like a very, extremely blunt instrument for dealing with it.

Much better would be some kind of a rating system or a content selection system or something that allows you to block out specifically those -- basically, gave you free disposal, what economists call it, allows you to freely eliminate any given component, ideally as fine grained as possible, that you would like to eliminate.

On the Internet there's something called a program for Internet content selection picks that allows a decentralized rating system. I guess there's the V-chip and other things like that for TV. That seems like -- That would seem to me a more targeted way of addressing this question of content that you don't want to view, rather than having some pre-set, very large bundles.

MR. : I agree. This is what Eric said, and it would not be unreasonable, depending on the cost, to just require cable operators to delete certain channels.

MR. : At the viewer's discretion.

MR. : Yeah, that people don't want. I mean, it would be a costly thing, but you know, politically it may be something that is reasonably plausible, and you just have to figure out what it would cost. But --

MR. : Even if it costs something, I mean, you know, I can see you saying -- requiring they do it for free, but you know, I think you have to pay to not have your phone number listed, you know. So you could imagine that, you know, you would have to perhaps pay to block out certain channels. But you know, the true cost would probably be pretty close to zero for doing that.

MODERATOR WALDON: Anyone else?

MR. : I was going to respond to

Eric's point about the investment in quality. The basic argument that some of us have worked on is that, if you are looking at the fixed -- (END OF TAPE3/ SIDE2)

(BEGIN TAPE4/SIDE1) They are asking how much do you invest in that content. Then you are saying how much comes back to me as a return to that incremental dollar put into the content investment.

The larger the number of people that are out there that can respond to that, either in terms of generating advertising revenue or in terms of paying for it, then the larger at the margin is the return of that dollar invested. That is sort of the connection between the size of the audience reached and the quality of the product.

Same thing goes along, whether it is advertising or whether it is payments. There is that connection. So you do look at it over a longer term when you are fixing that. I mean, once you produce it, yes. I mean, maybe for one year your budgets are fixed, but over time those budgets change over time, and we do see that happening.

Basically, network budgets, the broadcast network budgets in real terms have been falling, and probably because their audience has been shrinking. So there are quality effects here.

When I was alluding to the political side of it, it may be that -- You know, we are talking about -- If we are talking about values that extend beyond individual choice, then I want to live in a society that has people that are exposed to certain things. It's very similar to talking about investments in a school system and civics lessons and things like that.

So there are concerns here that go beyond the individual choice dimension.

MR. : I hadn't thought of that, that I might be affected by what you are watching, in essence. That's what you are saying? Yeah. So if I wanted to prevent you from watching certain things, that I might have an interest in doing that.

MODERATOR WALDON: So far this afternoon, we have been tiptoeing around what the sum of the speakers this morning might call the large elephant in the room, and that is the contracts between programmers and cable and satellite operators.

Let's begin with asking why do we see

these tying or bundling arrangements at the wholesale level? I'll leave it open to whoever would like to start.

MR. : Well, I think I already gave my reaction. I think it is a reaction to transaction costs, that it is difficult to deal with the complexities of the relationship with price alone and, therefore, you end up with the bundling.

It does create an advantage for those that have something to bundle. There is no question about that.

MR. : Well, I think there is probably a little more to it than that. I think part of it has to do with what I mentioned before, is the advertising. The programmers -- It's very important to the programmers to get a large audience so that they can get high advertising revenues.

In the long run, it's just like magazines or newspapers. You can buy the Washington Post for a fraction of what it costs to produce it, because of advertisers. You can do the same with magazines.

So the programmers are structuring

their contract with the operators to make sure that they maximize advertising benefits, and there's some sparks that fly between the operators and the program suppliers about that that have been in the trade press and others, because the operators don't care about the advertising, at least the industry as a whole.

The other reason they do it is very strategic effects. They want to be able to leverage -- You know, they tie their programs together, and they force them into one tier, partly because it maximizes their advertising, but I think you have to realistically consider the strategic incentives going on in the industry.

Networks -- Established programmers who want to try to start new networks can more effectively leverage them into the market by tying them to the more established networks. It is a strategy that works, and I think that it is something that they do.

It has certain negative effects and probably certain positive effects that we have talked about, but I think you have to recognize there is a strategic element and there is advertising and there's the transaction cost factor, and they are pretty powerful forces.

MR. : I would elaborate on that, and I agree very much with that. I mean, one reason is just the same reason for bundling that we talked about at the consumer level. But I think the one that maybe is worth thinking a little bit more about that I would be particularly concerned about is that there's anti-competitive reasons having to do with tying.

It has been shown that you can -- By bundling products, by tying products together, you can create a very powerful barrier to entry of people who have a similar substitute product. The example, I think, David gave was with the PET shows.

So if somebody has created or is contemplating creating a PET show, and you have your own PET show that you are bundling in, if you make the assumption that people who are already watching your PET show are less likely to then pay for a second PET show by an independent, you are going to reduce the incentives for that independent to create the PET show or to get picked up.

At a static level, that creates a barrier to entry. The bigger concern, I think, is over time that will reduce the incentives for people to create new content that competes with the content provided by the existing bundles.

So you can have a dynamic effect. I should also note in fairness that, in at least the models that I have analyzed, the incentives for innovation by the bundler are actually somewhat higher, because they now have an incentive to create a more valuable PET show, because they know that it is likely to be watched by more people.

So that is somewhat offsetting, but over time I would be quite concerned about the effects on innovation by new entrants being reduced because of these tying arrangements. That may, in fact, be a goal of some of the people requiring these tying arrangements.

MR. : So let me just add one small thing on that point. I'm sorry.

So you often hear in the economies of tying that there is no way to extend -- this is at least an old argument; I don't know if it is still held, widely held -- that there is no way to extend market power. If a firm with market power forces you to take something, it has to give up an equal amount in what it would have been able to charge for the valuable product.

I think -- My hope is that the view is being more widely spread that actually, especially in dynamic settings, that it actually can be used as a way to, in this case, get a new network onto a cable system and grow that cable system, in particular, because -- I think it was mentioned by a couple of people this morning, that just having space on the shelf exposes viewers to your network, and that is apparently, in their view, a necessary condition for growing a network.

If that is true, then there would be a strong strategic incentive to tie.

MR.   : Let me just say, I agree with what you're saying. It's stronger than that. It is not just having the space on the shelf. It is effectively that that PET show that is part of the bundle -- the marginal cost to the buyer is close to zero for getting that PET show, given that they've already got the other components; whereas, the marginal cost for the independent PET show is some positive number, presumably.

So you are forcing the independent to compete with somebody who is close to zero price. That is very difficult to do.

So it is not just a matter of giving them visibility. It is actually effectively pricing it at a very low and anti-competitive price.

MR. : I mean, this is -- For example, if you look at history of cable networking -- like Ted Turner started back in the 1980s after CNN was started. The satellite news channel was announced to ABC, and Turner immediately responded by starting CNN II, which later became Headline News.

I got a video tape of him talking about how this is a strategic move to run them out of business. So -- in effect. He didn't quite use those words, but he came very close.

A lot of these -- I think a lot of the program suppliers like MTV and News for many years, sports and those -- if you look at them, actually, they are very concentrated in terms of ownership, and usually one individual network has a very large majority of the share.

You know, networks have tried to enter weather, and the Weather Channel maintains a monopoly. I mean, I can give you a list of examples of these, and some of the strategies to create these fighting brands, you know, which is like CNN II says not enough (inaudible), and cable operators don't want to take too many news networks.

So these type of strategies do work. Just one caveat, though, to something that Eric said is that you have to be practical about this perhaps, which is that you have five major programmers, as was talked about this morning. So you at least got five of them who can compete with each other trying to start the PET channel.

What in practice happens if you watch it? It is like the magazine industry. Half of the magazines that are started are started by people in their garages or people with ideas, but you know what happens to those magazines real fast.

You have all those big corporations watching like hawks for these people with these ideas, and they go buy them up, and then they pump their money into them and get them on.

So the idea that you are not going to end up with a PET channel or you are going to end up with less PET channels because of this type of behavior is probably not true, because the person who has got an idea -- these big corporations are going to buy it, and they are going to compete with each other, you know, trying to get them on.

When you start talking about news and opinion and information, stuff like that, then things get very touchy, because you've got more concentration, and an independent person who wants to start a news channel just because they want to express their view or whatever and doesn't have other assets probably doesn't have much of a chance because of the strategic environment in the cable network industry.

People might think that is important, but when you start talking about PET channels, people may say who cares.

MR. : Actually, the situation David described is very similar to what we see in actually other media industries as well, like recorded music, that new genres like rock and roll or one of those tended to be introduced by independents. And as the acts became popular, then they were acquired by RCA and CBS and so on. The same thing with rap and so forth.

It is not an unusual process by which -- There are independents out there who are seeing new ideas and trialing it in some way. Once that is perceived to be something valuable, then people who can do a better job of promoting that tend to buy it.

I don't know if you should necessarily looked at that as anti-competitive. I think you are right that it doesn't necessarily mean you end up with -- I mean, there's two points to this -- with less variety in the long run or that the fact that, if you are going to allow people that are already established to buy what comes in, then maybe it is the same thing as if they introduced it themselves in the long run as well.

MODERATOR WALDON: Again, I would like to ask your advice as pretending again to be -- have the difficult job of being FCC economists.

Is there a way that we could -- Congress could ask us to design regulations that would allow us to get the benefits of these tied arrangements in the wholesale market -- you know, for example, saving the transaction costs -- yet eliminate the harms that you see that might be occurring, such as limiting entry, or is it a lose/lose situation?

MR. : One of my most immediate responses -- I am really glad I am not an FCC economist. As an academic, I can pick and choose my own question, but I don't pick the ones that are as hard as you have to deal with.

Maybe one response to this, though, is a bifurcation of regulation. That is that, if there are competitive issues, that that really is an anti-trust question, and perhaps not one that should be dealt with by the FCC. That would be my -- You know, bifurcation of regulatory or legal responsibility would be one suggestion.

MR. : Well, I think Eric had the only idea about this is really going to work, which is that you could require the cable operators, perhaps with a fee, to allow people to eliminate programs that they don't want.

I think the other thing is that the least worst scenario, if you have to regular something, is not to require the operators to do things, but to try to create an environment where they have an incentive to offer things that consumers want; because they have a perfectly good incentive to offer mixed bundling if their costs are low enough.

This is a well known result. Mixed bundling is always better than forced bundling at some price, and as long as the costs are low enough. So if you create an environment where the cable operators have an incentive, and the DBS people have an incentive to proceed with cost effective things like offering themed channels and stuff like this, this is the only way to go, I think.

The only specific regulations I can think of that will be conducive to that are some forms of regulations of the types of contracts that the programmers have with the operators.

I don't recommend that, but it is probably a least worse situation, partly for the reason Steve talked about, is that you start to get into -- If the Commission starts to get into the business of regulating these contracts and requiring things that they can say and not say, they will figure out a million different ways to undermine the whole thing, because they have very powerful incentives to keep things like they are, and they are incentives that make good economic sense.

If you start fiddling with them, you are going to get in trouble. I mean, you could say something like there is no ties, you cannot tie networks, one or the other. Transactions costs would go up, because then every negotiation would be in individual networks.

You might have bad effects on overall entry of small networks and stuff like that. You probably would. But it might not be that terrible. If you had to do this regulation, I think that would probably be a somewhat less horrible way to do it.

MR. : I would say the pink elephant in the middle of the room is the one that we haven't talked about, which is competition. I would think that the optimum way to solve many of these problems is to promote competition in distribution, and Eric mentioned it earlier.

For the specific issue, one would hope that would also promote competition in program supply, which I think it would. That was a little trickier because of the high fixed cost of producing programs.

If there are consumers that are very dissatisfied with the bundle -- and these would presumably be the ones that have very high value for one or a few cable networks -- if there is competition in distribution, that need will be served.

So it would seem that that has not yet occurred, perhaps just because there are enormous costs for distributing this kind of programming. But that is, I think, the appropriate direction to pursue.

I don't know to what extent the FCC can do that in terms of making bandwidths available for wireless cable and that sort of thing, but I think that is the direction that you ought to try to look.

MR. : Yes, I wholeheartedly agree with that. Competition at all levels, certainly at the level of the operators, and there are certainly some high fixed costs involved, but there are also things like satellite that allow multiple ways of -- multiple conduits for getting into the consumers' homes.

That seems to be a dramatically more important lever for promoting consumer welfare than fiddling with, you know, the amount -- the size of bundles or a la carte or whatever. And for that matter, competition at other levels, at the level of the content providers, too.

I mean, you know, it is good that there

are on the order of five big groups, but I think we would want to be very careful that that number doesn't get smaller on the mark, and do what we can to make it bigger; because that also is going to help a lot in promoting consumer welfare, total welfare, innovation, variety, efficiency.

All of those are unambiguously improved by doing that, whereas, as you've heard, rearranging the a la carate versus bundling issues is a little bit like rearranging deck chairs and not paying attention to the big picture of where real welfare comes from.

MODERATOR WALDON: Actually, we have brought up competition. I want to give David and Steve an opportunity to address, you know, what can we do additional to increase competition. Any suggestions?

MR. : I guess, when I look at things, my impression -- and this is really a casual view of the market evidence -- is that consumers don't seem to really be that unhappy with the bundling they see. And if they were, then you would think that would provide a competitive wedge for the satellite people to take away more of the subscribers, and we don't see satellite responding with anything dramatically different.

There are, you know, the minority players in the market that have the most to gain. So on the basis of casual appearances, that suggests that maybe there aren't those problems.

I would note that, even if we had bundling and 92 people offering identical bundles, then you would probably still see the kinds of relationship you are identifying empirically for your older data that really refers to the strong satellite competition -- prior to the strong satellite competition era.

Maybe another way to look at this -- and there was a market -- maybe there still is -- in which there was a large number of people offering very similar bundles, and they are offering multi-channel services. That was the home satellite dish industry.

The nature of that industry -- There are still people with the big dishes in their backyards. There used to be several million subscribers of these. I would guess there were over a dozen companies who were reselling the cable channel to the backyard dish people.

It's been ten years since I looked at

this, but when I did, it seemed to me that everybody was offering pretty much the same bundles, and they were bundles that looked like the ones that were offered by the cable systems.

This was all addressable as well. You could pick exactly what you wanted. So again, this is another piece of casual empiricism, but it suggests that, in that case, the bundling didn't seem to be the competitive outcome.

It is not obvious to me what we do, other than adding more satellite capacity. I think that -- I don't think you are going to see much wire line competition. That's pretty much proven itself to be a non-starter again and again and again.

So unless it is cable or unless it is satellite or perhaps some of these broadcast initiatives that are somewhat constrained in capacity but, nevertheless, that are offering the kind of bundles the consumer advocates were talking about with sort of a stripped down basic -- you know, the over-the-air channels plus some of the prominent basic tiers -- this may be the market test we are looking for.

MR. : Well, I can't think of

anything that I would do about this that I think would be actually a good idea. I mean, I think it is even more of a -- I mean, you work with rate regulation. I mean, you have this huge mess -- okay? -- and they evade it largely and everything like that. But you could look at the data two years later after the FCC spent years and years doing this, and it turned out that rates did finally go down somewhat.

But in a case like this -- In spite of those sacrifices, in a case like this, I just can't think of anything. I might be able to, if I give it some more thought, but I can't think of anything that would -- the FCC could probably productively do to improve the situation from what I think it is now.

MODERATOR WALDON: I'll take that as a compliment. Thanks. Anybody else want to expand on that?

MR. : I am just increasingly glad I am not an FCC economist.

MODERATOR WALDON: Actually, what I would like to do now is maybe start to summarize. So I would like to ask each of you just to leave us with as extensive of parting thoughts as you would like.

Greg, I know you have a plane to catch. So you have the honor of going first, and if you run out in the middle of the rest of us, we forgive you.

MR. : Thank you. So I hate to beat a dead horse. I think I mentioned this twice already. I think, you know, we have covered all the highlights, that there are certainly discriminatory reasons for cable systems to bundle, and that this may in fact actually enhance the quality of -- quality and number of cable networks that we see.

I sort of see myself as the empirical economist on the panel, and so I take that as my mandate to try to actually be able to answer the questions that people are asking.

So as I say, I mentioned this before, but I think the key to -- You know, I think, so Booze Allen & Hamilton presented a model this morning, and Consumers Union tore it apart.

I think that is generally very easy to do, because models inherently are based on assumptions. Unless you can take models to data to see what the data have to say, I think it is very hard to make definitive policy recommendations.

So you know, I think actually partnering with cable systems or partnering with program networks, in part with cable systems, to try to get at the underlying key components, which in my view are the demands for the networks, any complementarities or option values associated with those, trying to capture experimentation incentives, and then on the cost side the costs -- trying to assess the costs of unbundling -- that trying to empirically estimate those key objects are, I think, what we need to begin to address what would the optimal set-up look like.

So I encourage anyone who has any insights on how to do that to contact me or just to do it themselves for the greater good.

MR.   : Well, let me compliment and comment Greg for doing the empirical work. I think that is absolutely the direction we want to go, and I was somewhat gratified that his empirical findings were broadly consistent with a lot of what the theoretical work was in terms of what happens when you have bundles to prices and producer and consumer surplus and quantities.

I just want to stress at the risk of

overemphasizing it, but I think that there is a very common presumption about treating these information goods the same as other goods. It really makes a huge difference whether the marginal cost of the good is close to zero or whether it is a significant positive number.

Bundling is generally a pretty bad idea and destructive for most of the goods that we deal with in every day life. It is something that forces people to have something that they don't value as much as the price and, therefore, you are destroying -- the cost of producing that good is, therefore, wasted to society.

I think a lot of people come to cable TV with that set of intuitions, because most of the things we buy when we are very young have this characteristic, that there is a positive marginal cost of producing it. But cable content and, for that matter, digital music, Internet content, radio and a number of other types of content, have a very low, nearly zero marginal cost of delivery.

So a lot of the intuitions that we bring to the problem are 180 degrees wrong. We have to be a little bit careful about it.

In particular in this world where

marginal costs are close to zero, then total welfare is maximized by having the good as widely available as possible to anybody who has a non-negative valuation for it. So you know, with this caveat that you can dispose of things that -- or block out things you don't want, then ideally you want to make it available to everybody.

That is not true for goods that have a positive marginal cost of producing. It would be wasteful to try to give everybody access to physical goods.

So if it is true that you want to make the good as widely available as possible, then it can also be shown that oftentimes -- usually, bundles will lead to a greater quantity sold than a la carte or other types of pricing schemes, at least having the bundle available, and total welfare will tend to be maximized in that kind of a world.

That is what, I think, a lot of us have been saying. Although you have heard some "on the one hand/on the other hand," that particular result, I think, is fairly robust, at least for large bundles of information goods, which is what we are talking about.

That said, I think there are some other important characteristics that we want to bear in mind in this debate. One is this important question of product variety, innovation. Often the most important welfare effects come not from the price but from product variety.

We did a study where we looked at the value of product variety in online markets for books and music and videos. We found that the importance of product variety was 10 times greater in terms of the consumer welfare effects than the differences in prices.

So it is something that we shouldn't ignore. I should say, it can be quantified to a fair extent with recent models. That is something that also is affected very much by these decisions.

Again, most of the direction is that larger bundles tend, at least in most of the analyses I have seen, to facilitate greater product variety, especially for relatively obscure goods that would have difficulty getting distribution otherwise.

Then finally, the third point that I think we want to make sure we highlight in the discussions and in the thinking about it is the dynamic nature of all of these markets.

What I have been saying so far and what we've been talking about is sort of these static analyses of bundle versus other approaches, but the most effects in the long run are probably what it does to innovation and incentives for entry.

There, I don't think that the case for bundling is that strong. In fact, you can make a good case that bundling inhibits incentives for entry and innovation by people who aren't already a part of the bundle.

They may have a more difficult competing in that kind of a world and, therefore, realizing this, their venture capitalists or their other funders or they themselves may decide to not invest as heavily in creating content.

That is something that we would want to be very wary of, because ultimately a few percentage points of dead weight loss here or there in today's economy is going to be swamped by what happens to the rate of growth of that welfare, and that rate of growth is going to be a function of incentives for innovation and new ideas and new goods and new products being introduced in the marketplace.

That is something that, as I think it was maybe Steve had said earlier, hasn't been analyzed nearly as extensively.

There is one paper that Janis Bacose and I did called "Bundling and Competition on the Internet" where we tried to very explicitly consider these tradeoffs. Also Barry Nailboff (Phonetic) has analyzed them to some extent, but it is certainly an area that calls for a lot more research, because ultimately that is going to be the main driver of consumer welfare.

MR. : Well, first I also want to recommend Greg's study. I've been talking for 45 years about these value averaging effects in bundling, and this is the first empirical study that actually tries to measure these.

On the other hand, I am not sure exactly how knowing all this really helps a policy that much, except perhaps to reassure us that these things are actually happening, but I already assumed they were anyway. So -- but anyway, other people may not.

Anyway, I very much agree with everything that Eric said about this and the value of innovation and all this kind of thing. I guess my own take on this, you know, is that I am sympathetic, you know, as I said, to the consumer attitude toward this.

It is really a kind of a -- It's kind of a dilemma. You would make some people better off, probably a fairly small slice of people at most, by doing this. But the problem is anything that you do to try to force a la carte and to less bundling -- almost everything you do has some kind of a negative effect, which i think is probably going to swamp other things.

I would again emphasize this advertising thing. I mean, this is really a key issue in the industry, and I think it is a very powerful motivating force behind the way that the programmers behave, is they want to maximize the size of their audience, and they write their contracts to do that.

As soon as you try to force a la carte, then that starts to undermine the advertising, and that has a feedback effect, which is actually going to raise costs to consumers or reduce the quality. Now what the empirical effects are, I'm not sure.

Eric made his points about preserving environment -- about innovation, and I agree with this. There are different takes on this, and I am very sympathetic to the attitude, you know, that you do want to preserve situations where independents have a better opportunity to get into the industry.

It is true that you could -- By restricting programmer contracts, you probably could improve that, but I think that the FCC getting involved in that is probably not the best idea, and there are a lot of side effects that that may make it worse as well.

I mean, as far as variety goes, I was impressed with something Eric said about the way people value variety. I mean, cable -- Look at cable networks. I mean, there is an incredible skew, and some of this data was out before.

Look, 90 percent of the advertising revenues and 90 percent of the viewing are in about the top quarter or top third of the networks. I would say probably the last 100 networks, if you just blew hard at them, they would all float away.

I mean, in economic terms, they are very small. I think that they probably exist in large part because -- You know, they make tiny revenues, and in large part they probably exist because operators have a relatively low marginal cost of capacity.

So if they can carry these and say, look, we got 200 networks, take your pick, you know, that is something that impresses consumers, and they like that, and they have the option.

You know, Bob Pepper (Phonetic) was making the point at lunch about the option value that subscribers have, and they feel wealthy, you know. You get these 200 networks. Even though they amount to practically nothing, you know, it is value, and people do that.

It is a good chance, if you start tinkering with this stuff, that those networks are going to blow away. There's a pretty good chance a lot of them will.

MR. : I guess that leaves it to me, with not a lot to say.

I do want to talk a little bit about the small networks. I think David is right. It wouldn't take much to undermine them and have them disappear.

My again casual impression is, though, that there are large numbers of small audiences that intensely value some of the stuff that I consider pretty crazy and wacky on these small networks.

You wouldn't have predicted three or four years ago you would see people that are making choppers -- you know, custom choppers in California becoming, you know, something like a hit, or Monster Garage and things like that or this thing on, I guess it's Spike now, where you have these -- you know, it's a Japanese program. People are doing these crazy things with the voice-overs in English that sound like something different, things you wouldn't have imagined.

So there is a lot of creative ferment that gets picked up other places, and I think that these networks have a value as a springboard for new ideas. Unfortunately, a lot of it is the reality stuff that I don't like, but nevertheless, a lot of people do.

It is important that we remember that there are strong efficiency motivations for bundling. You know, what has been emphasized today, by and large, are the demand side effects, but once the efficiency components are there, and if you do bundle for efficiency, then you are going to get the demand side effects as well.

I think that makes it difficult to distinguish whether what you are observing has been done for the demand effects or the efficiency effects. Since you are going to get the demand effects anyway, the aggregation effects that Eric talks about are empirically -- you know, the law of large numbers operates pretty powerfully. So you are going to see that anyway.

You can't look then -- It's too bad Greg left, because this is part of his paper. You can't say, because you see the demand expanding effects and increase in elasticity, that the motivation for the bundling was for the demand aggregation effects as opposed to efficiency. You are going to see that anyway.

The question, is it possible to improve over the current situation: David said that he couldn't think of any way. Off the top of my head, I can't think of any way either.

That doesn't mean that conceptually there is not a way to do it. But what my fear is, that we don't have the information either about the costs, certainly about the dynamics, or about the demand interactions and how those will change over time to make it possible to really make a very informed decision about such things.

So while it is not inconceivable that there is not a way to make things better, I think it is an extremely risky thing to venture, given the kind of information we have. And given the nature of the industry, I think it is going to be difficult to get the information we would need to make it better.

So basically, I would be very cautious in that regard.

MODERATOR WALDON: Eric, did you have --

MR. : I just want to add another couple of thoughts. I think we need to be in a position to give you better advice, and I found it a little frustrating that we weren't able to give you as good advice as we should have been able to.

So I would like to make an invitation to my fellow economists and to industry for us to do more empirical work, along the lines of what Greg did. But that is really just scratching the surface, just beginning.

I think there are some opportunities for some well designed experiments to really answer much more unequivocally these questions about bundling is affecting consumers and producers. There are some theoretical predictions, but they are based on necessarily simplified assumptions.

It is not that difficult or that unsolvable a question to do a lot of this empirical work and go out and do some controlled experiments. I have done the same sort of thing with online markets with companies like Amazon, and I would be delighted to explore it more with cable operators or other providers of information goods.

I think we could really crack this much more explicitly, rather than just talking about hypotheticals, to a large extent, and that would put us in a position to give better advice.

I think also, from the position of theory, there is a lot that could be done. We talked a little bit about innovation in this industry, but there should be some innovation among the economists and the people developing the models as well in terms of how we think about the problem of generating revenue for paying for information goods.

So far the parameters have been really small -- you know, bundling, a la carte, mixed bundling. But there are a lot creative ways.

Advertising, actually, is another one that David brought up quite a few times, a lot more innovative potential revenue mechanisms.

I think of ASCAP and what they have done in terms of distributing revenues to music producers or what Steve Jobs has been playing with, with downloading music, or in the movie -- in the video rental industry, a few years ago someone came up with the idea of revenue sharing which has apparently generated about an extra billion dollars worth of revenues and surplus compared to the previous model where the videos were just sold to the rental stores.

So I think we can be more creative about inventing new ways of paying for content and distributing the value from that content to the innovators that are very different from the way we buy and sell physical goods.

I think information goods open up all sorts of new possibilities. So there is another invitation to the theorists as well as to the empirical researchers, and I suspect that will open up all sorts of opportunities for improving overall welfare.

MODERATOR WALDON: Anyone would like to

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MR. : Yes. I guess I would just agree with Eric in terms of -- I mean, a lot of the things we discover are sort of by looking at the way things have actually been and figuring out the logic that underlies it.

What I wouldn't want to do, though, is to say that as an economist I figured out a new way to extract revenue from consumers, and then turn around and say the industry should do this. It is one thing to say that I've discovered something. It is another thing to say that I know that this is prescriptive and that a policy maker should be able to act on that and should say that there is a business case for something that Wildman or Waterman or Brynjolfsson has discovered.

MR. : Why not -- I think I missed it. Why wouldn't you want to prescribe something that you thought would create more value?

MR. : I wouldn't mind recommending. What I wouldn't want to do is to make it a policy requirement, because again we are moving from the theoretical to the actual empirical environment, and you always uncover these undiscovered things as you implement.

So I think it is great to discover ideas. It is another to say the FCC should mandate that these ideas be implemented, employed. In some way, they are trial by people that are out there.

I guess that was one of the reactions I had this morning to some of the suggestions saying the industry would be better off by doing this. Well, then there should be a rush to implement these suggestions.

If there is not, then you either -- implicitly you are saying these people are just incredibly stupid, which is sort of what economists say all the time, implicitly, or there must be more nefarious motives. But then you are left to identify those as well.

MODERATOR WALDON: Well, I would like to thank everyone who came here this afternoon. I want to thank our distinguished speakers who were so kind to donate their time to help the Commission better understand the issues before us, and remind everyone that the reply comment period is still open.

So if you want to add additional information to the record on here, please do so.

Thank you very much.

(Whereupon, the foregoing matter went off the record.)

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