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Cracking the Cable Conundrum: Government Regulation of A La Carte Models in the Cable Industry

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ABSTRACT

This Article examines the practice of cable bundling, a term describing how cable providers offer channels in "packages" of channels rather than allowing consumers to buy channels individually. These cable bundles have been criticized by politicians, academics, and the public alike, many of whom believe cable bundling simultaneously increases the price of cable and forces consumers to pay for programming they neither want nor use. Politicians have responded to these criticisms by advocating for legislation requiring cable companies to offer *a la carte* pricing options, in which customers can pick and choose individual channels. But evidence that an *a la carte* requirement would improve consumer satisfaction is scarce. Government intervention would introduce new inefficiencies to the market, thereby increasing consumer costs. Additionally, if the much maligned bundle is truly inefficient, any need for government regulation will likely be obsolete in the near future. The growing popularity of new media platforms such as Netflix, Hulu, and HBO Go will almost certainly necessitate more consumer-friendly offerings from cable companies sooner rather than later.

AUTHORS

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INTRODUCTION

Prominent politicians and consumers alike are deeply concerned with the state of cable in America. In fact, some senators have reported that their constituents are more concerned about expensive cable than highly politicized issues like gay marriage.[1] Senator John McCain has described cable as an unwarranted "tax" on Americans[2] and recited in front of the U.S. Congress the tragic tale of a seventy-four-year-old widow who was forced to pay nearly seven dollars a month for ESPN.[3]

High prices in cable are largely attributable to the existence of cable bundles. In the United States, every cable television provider offers packages of channels as its main offering. It is impossible for consumers to purchase the vast majority of channels individually—most channels are offered only as part of a bundle. Consumers who want to purchase one channel out of a twenty-channel bundle have to request and pay for all twenty.

Despite the possibly hyperbolic comments from politicians regarding the ill effects of cable bundling, their views are generally in line with those of the American people. For example, when presented with a theoretical "a la carte" alternative wherein individual channels are made available for purchase, 92 percent of consumers said that they would be at least "somewhat likely" to switch to a full a la carte option.[4]

To address the concerns surrounding cable bundling, several solutions have been proposed, including a mandate that cable providers offer a la carte pricing to consumers.[5] This Article analyzes whether such a solution would be beneficial. Part I discusses the background of the cable bundling and a la carte models, Part II describes the potential benefits and drawbacks of an a la carte model, and Part III analyzes arguments concerning why government intervention may not be the best means of addressing the cable bundle problem. Part IV explores the future of cable given the increase in internet viewership

1. Adam D. Rennhoff & Konstantinos Serfes, *Estimating the Effects of a la Carte Pricing: The Case of Cable Television* 1, 2 (Jan. 18, 2008), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1085392; WASH. POST, *A la Carte Cable Served Up as Solution*, PITTSBURGH TRIB. REV., Mar. 27, 2004, http://triblive.com/x/pittsburghtrib/business/s_186582.html#axzz2wGzY5aLg.
2. Mike Oznanian, *Senator McCain's Cable TV Bill Intended to Target Sports Fans But Would Be Bad for Everyone*, FORBES, May 4, 2013, http://www.forbes.com/sites/mikeozanian/2013/05/14/senator-mccains-cable-tv-bill-targets-sports-fans-but-would-be-bad-for-everyone.
3. *Id.*
4. Mike Farrell, *Study: 92% Want A La Carte-for Cheap*, MULTICHANNEL NEWS, Apr. 23, 2013, http://www.multichannel.com/content/study-92-want-la-carte-%E2%80%94-cheap.
5. Oznanian, *supra* note 2.

alternatives like Netflix and Hulu and highlights signs that the market is already gravitating toward an a la carte system without government regulation.

I. CABLE BUNDLING AND THE A LA CARTE MODEL

Cable bundling refers to the practice of cable companies offering consumers a package of channels, rather than offering channels on an individual basis.[6] Under the current bundling system, "cable prices have increased by an average of 4.6 percent per year and in excess of 7 percent per year for the expanded basic program tier over the past five years."[7] This increase in cable prices amounts to about three times the rate of inflation over the same time period.[8]

While the price of cable has increased, the options for consumers within each cable package have also increased. Although cable companies provide customers with the flexibility of viewing hundreds of channels, the flexibility they have in choosing cable packages as a whole is minimal. While each package may have hundreds of channels, consumers might only have the option of choosing between three packages. It is unclear that consumers desire this much viewing flexibility—today, the average household receives 137 channels but watches only 33 of those channels each month.[9]

Politicians and consumers alike propose eliminating the cable bundling model because they believe offering channels in this manner effectively forces people to pay for products they do not want.[10] Specifically, consumers believe

6. James Surowiecki, *Bundles of Cable*, NEW YORKER, Jan. 25, 2010, http://www.newyorker.com/talk/financial/2010/01/25/100125ta_talk_surowiecki.
7. FED. COMMC'NS COMM'N, REPORT ON CABLE INDUSTRY PRICES 3 (2013), http://www.fcc.gov/document/report-average-rates-cable-programming-service-and-equipment-1 ("The average monthly price of expanded basic service . . . for all communities surveyed increased by 4.8 percent over the 12 months ending January 1, 2012, to $61.63, compared to an annual increase of 2.9 percent in the Consumer Price Index (CPI).").
8. *See id.* at 15 ("Expanded basic cable rates increased by . . . a compound average annual rate of 6.1 percent over the 17-year period from 1995–2012.").
9. Spencer Wang, Head of U.S. Internet & Media Equity Research, Credit Suisse, Presentation to Nielsen Global Client Council 12 (Oct. 18, 2012), *available at* http://nielsen.com/content/dam/corporate/campaigns/gcc/NielsenGlobalClientCouncil_IndustryInsights-SpencerWang.pdf.
10. *See* Alex Sherman, *Bundled Cable TV Withstands Consumer Opposition*, BLOOMBERG BUSINESSWEEK, Nov. 14, 2013, http://www.businessweek.com/articles/2013-11-14/2014-outlook-cable-bundling-and-higher-bills-wont-stop-soon; Bruce Walker, *Consumers Will Lose if Cable Is Unbundled*, U.S. NEWS & WORLD RPT., Sept. 17, 2013, http://www.usnews.com/debate-club/should-consumers-be-allowed-to-unbundle-their-cable-packages/consumers-would-lose-if-cable-is-unbundled (challenging Sen. John McCain and Sen. Richard Blumenthal, who proposed the "Television Consumer Freedom Act of 2013," for their presumption that replacing channel bundling with a la carte programming would benefit consumers by mitigating the financial burden consumers currently bear in paying premiums for channels they do not want).

their cable bills would be lower if channels were offered on an individual or a la carte basis because they would have to pay for only the channels they actually want to watch.[11] In contrast, the bundling business model has been characterized as a tax on Americans because certain households end up subsidizing the more expensive viewing preferences of other households.[12] This is particularly true of those who pay for but do not watch sports programming, which is estimated to cost consumers over twenty dollars per month on their cable bill.[13] The typical sports bundle includes ESPN, which adds about six dollars per month to a consumer's cable bill, and various Fox Sports channels, which cumulatively add around seven dollars per month.[14]

Consumers believe that the economic appeal of an a la carte model is as follows: Cable would be cheaper if consumers paid per channel. Instead of paying a hundred dollars for a hundred channels, they could possibly pay a prorated amount of five dollars a month for five channels.[15] Following this logic, consumers believe that their cable bill would be drastically reduced if cable companies charge only for the channels consumers want, which in many instances amount to only five or six channels. This line of reasoning relies, however, on the assumption that cable companies would not respond to regulations by changing the average price per channel in order to maintain profits.[16]

The evidence of the a la carte model actually reducing consumers' cable bills is disputed. Many studies show not only that cable prices would be unlikely to decrease under an a la carte system but also that an a la carte system would actually increase prices, especially with respect to the sports channels that already compose a large portion of a consumer's bill.[17] A 2006 review of a la

11. *See* Sherman, *supra* note 10.
12. Oznanian, *supra* note 2.
13. *See* Derek Thompson, *How Watching 'Unbundled' ESPN and AMC Could Cost More Than Your Whole Cable Bill*, THE ATLANTIC, July 18, 2013, http://www.theatlantic.com/business/archive/2013/07/how-watching-unbundled-espn-and-amc-could-cost-more-than-your-whole-cable-bill/277916.
14. *See id.*
15. *See* Matthew Yglesias, Commentary, *À La Carte Won't Fix Cable*, SLATE (May 14, 2013), http://www.slate.com/articles/business/moneybox/2013/05/mccain_s_la_carte_cable_bill_is_bad_deal_for_consumers.html ("The problem starts with a fundamental misunderstanding: the delusion that if your basic package contains plenty of channels you never watch, you're paying for many channels you don't watch.").
16. *See* Rennhoff & Serfes, *supra* note 1, at 2.
17. *See, e.g.*, FED. COMMC'NS COMM'N, REPORT ON THE PACKAGING AND SALE OF VIDEO PROGRAMMING SERVICES TO THE PUBLIC 26–77 (2004) [hereinafter FED. COMMC'NS COMM'N, REPORT ON THE PACKAGING], *available at* https://apps.fcc.gov/edocs_public/attachmatch/DOC-254432A1.pdf; Thomas W. Hazlett,

carte cable found that in fact "costs for both operators and subscribers increase when basic cable tiers are customized."[18]

Nevertheless, other studies have found that an a la carte model would indeed lower cable prices. For example, one independent study concluded that the average cable bill would fall by 15 to 20 percent under an a la carte system but that cable companies' profits would also fall.[19] The same study found that some programming networks would benefit while others would be harmed.[20] The study used industry data and hypothesized how content producers and cable providers would react to market conditions under an a la carte system.[21]

The dispute over the effects of a la carte pricing exists even within the agency responsible for cable regulations. The Federal Communications Commission (FCC) published reports in both 2004 and 2006 on a la carte cable pricing. The 2004 report concluded that there would be little benefit to consumers from a la carte pricing, thereby making an a la carte system undesirable.[22] The 2006 FCC report reached the opposite finding, concluding that consumers would see "substantial benefits" from an a la carte model.[23] In examining the two studies, the Congressional Research Service found that "none of the studies or reports issued" by the FCC were "definitive."[24]

One specialist in the telecommunications policy field, Charles Goldfarb, attempted to make sense of the conflicting FCC reports. In a Congressional report, he mentioned that neither study was based on an FCC-developed model.[25] Instead, each model is based on estimates made by the National Cable & Telecommunications Association.[26] The uncertainty and different results in the FCC reports comes as no surprise considering the large number of potential responses, and interactions between them, that the parties involved might

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Shedding Tiers for A La Carte? An Economic Analysis of Cable TV Pricing, 5 J. ON TELECOMM. & HIGH TECH. L. 253, 257 (2006). *But see* FED. COMMC'NS COMM'N, FURTHER REPORT ON THE PACKAGING AND SALE OF VIDEO PROGRAMMING SERVICES TO THE PUBLIC 18–22 (2006) [hereinafter FED. COMMC'NS COMM'N, FURTHER REPORT ON THE PACKAGING], *available at* https://apps.fcc.gov/edocs_public/attachmatch/DOC-263740A1.pdf.

18. *See* Hazlett, *supra* note 17, at 257.
19. *See* Rennhoff & Serfes, *supra* note 1, at 1.
20. See *id.*
21. See *id.*
22. FED. COMMC'NS COMM'N, REPORT ON THE PACKAGING, *supra* note 17, at 26–27.
23. FED. COMMC'NS COMM'N, FURTHER REPORT ON THE PACKAGING, *supra* note 17, at 3.
24. CHARLES B. GOLDFARB, CONG. RESEARCH SERV., THE FCC'S "A LA CARTE" REPORTS 15 (2006), *available at* http://www.policyarchive.org/handle/10207/2789.
25. *See id.* at 2.
26. *See id.*

have.[27] The responses of consumers, program networks, and cable operators must all be accounted for in the model. In addition, the FCC does not have a comprehensive data set, forcing it to rely on assumptions rather than concrete numbers.[28]

A. Why Does Cable Bundling Exist?

If consumers do not want cable bundling, and if cable bundling is potentially expensive and inefficient, why does it exist in the first place? Cable bundling and the high prices associated with cable are recent issues dating back about twenty years. Before 1992, the big four networks of ABC, CBS, NBC, and FOX were considered a public good and by law had to be available for free.[29] These networks observed that cable providers were paying niche cable channels like ESPN, CNN, and Discovery.[30] This seemed unfair to the big networks because they were offering shows with higher ratings, yet were forced to provide programming to the cable providers for free.[31]

The cable providers' world turned upside down in 1992 when they lost the upper hand in deciding what channels were delivered to the homes of viewers across the country. In 1992, with the Cable Television Consumer Protection and Competition Act (CTCPCA), Congress made it legal for the big four networks to charge providers for their content.[32] But cable providers did not immediately kowtow to the big networks by paying them for their content, but rather refused. After all, they were understandably reluctant to pay for content that they used to get for free.

The refusal of the cable companies to pay for the big networks' content created a standoff. Networks were unwilling to turn over broadcast rights to their precious hit shows for free, and the cable company refused to pay the "greedy" networks.[33] This standoff ultimately resulted in a compromise that haunts cable providers to this day.[34] Specifically, the compromise allowed the cable providers to receive more channels and content from the network owners

27. *See id.*
28. *See id.*
29. *See Planet Money: Episode 488: The Secret History of Your Cable Bill* (NPR radio broadcast Sept. 27, 2013) [hereinafter *Planet Money*], *available at* http://www.npr.org/blogs/money/2013/09/27/226891181/episode-488-the-secret-history-of-your-cable-bill.
30. *See id.*
31. *Id.*
32. FED. COMMC'NS COMM'N, REPORT ON CABLE INDUSTRY PRICES, *supra* note 7; *see Planet Money*, *supra* note 29.
33. *See* FED. COMMC'NS COMM'N, REPORT ON CABLE INDUSTRY PRICES, *supra* note 7.
34. *See id.*

in a way where the cable provider technically did not have to pay for the big network shows.[35] This compromise resulted in a new set of channels like FX (created by FOX) and MSNBC (an offshoot of NBC).[36] The downside of this compromise was that cable companies were required to bundle these additional network-owned channels to carry the major network affiliate in the market. As a result, the cable bundle was born with more content for viewers at the cost of higher cable bills.

Negotiations between the networks and cable providers continue to this day, and these negotiations often result in standoffs.[37] At the end of every year, networks must renegotiate their licensing terms with the cable providers, and failure to agree to terms can result in publicized disputes such as the recent refusal of CBS to provide any channels to Time Warner Cable.[38]

Channels that are now considered mainstream and vastly popular like ESPN may have never had a chance under the a la carte system.[39] While ESPN is now one of the most widely viewed television networks, it was not always.[40] When ESPN first aired in 1979, it advertised itself as being a form of "sports heaven" and set up its office in Bristol, Connecticut rather than in a swanky New York City studio. ESPN also had to pay cable providers to be included in their cable packages as opposed to getting paid for its content license.[41] When ESPN eventually became more popular, it was able to bolster its power with the cable providers, thereby switching the power dynamic. As ESPN succeeded and millions of people began tuning into the startup, ESPN could demand more money from the cable companies.[42] Other niche channels like Discovery and CNN also started in a similar way.[43] Now incurring expenses to carry such channels, the cable companies now pass these costs on to the consumers.

35. *See id.*
36. *See id.*
37. *See, e.g.*, Dan Bobkoff, *The History–And Future–Of Cable's Bundling* (NPR radio broadcast Aug. 7, 2013), *available at* http://www.npr.org/2013/08/07/209820647/the-history-and-future-of-cables-bundling.
38. *See, e.g.*, *id.*
39. *See id.*
40. *See id.*
41. It was so unproven that "[i]n its early days, ESPN actually paid cable providers to get into your living room." *See id.*
42. *See Planet Money*, *supra* note 29.
43. *See id.*

B. Government Attempts to Regulate the Cable Industry

Government attempts to regulate the cable industry began in the 1960s when federal regulators enacted rules to block cable television operations in large markets to protect broadcast television from upstart competitors.[44] These rules were later overturned in the 1970s as cable grew in popularity across America.[45] More deregulation ensued in the mid-1980s but slowed following complaints regarding rising rates and the monopoly power of cable companies.[46] The 1992 Cable Act soon followed, along with the rise in cable prices.

As cable bundling led to ever increasing cable prices, Senator John McCain attempted to pass the Consumers Having Options in Cable Entertainment (CHOICE) Act in 2006 to mandate an a la carte model.[47] The bill ultimately failed and cable prices continued to soar.[48]

The Television Consumer Freedom Act (Television Act) is the latest bill attempting to regulate the cable industry—it was introduced by Senator McCain and later supported by Senator Richard Blumenthal.[49] If passed into law, this bill would have the effect of providing significant incentives for cable distributors to offer channels on an a la carte basis.[50] Senator McCain claims that the Television Act is strictly voluntary and would only provide incentives for cable companies to switch to an a la carte program rather than strict requirements that they do so.[51] But many of the Television Act's provisions would effectively force many cable companies to adopt an a la carte type model. For example, the use of a cable compulsory license, which is key to many cable operations, would be stripped if a cable company refused to provide a la carte services, rendering the choice to stay with bundles a practical non-option.

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44. Stanley M. Besen & Robert W. Crandall, *The Deregulation of Cable Television*, 44 L. & CONTEMP. PROBS. 77, 78 (1981).
45. *See* Hazlett, *supra* note 17, at 254. When such rules were swept away in the "deregulation wave" of the middle to late 1970s, a cable "gold rush" ensued during which the country was wired for multi-channel video service. *Id.*; *see* Besen & Crandall, *supra* note 44.
46. *See* Hazlett, *supra* note 17, at 254.
47. *See* Derek Thompson, *Can John McCain Break Up the Cable Bundle Forever? (No, Probably Not)*, THE ATLANTIC, May 9, 2013, http://www.theatlantic.com/business/archive/2013/05/can-john-mccain-break-up-the-cable-bundle-forever-no-probably-not/275735.
48. *See id.*
49. *See id.*
50. Joe Flint, *John McCain Introduces Television Consumer Freedom Act of 2013*, L.A. TIMES, May 9, 2013, http://www.latimes.com/entertainment/envelope/cotown/la-et-ct-mccain-cable-20130509,0,2224732.story#axzz2m6qrtEjP.
51. *Id.*

C. International Attempts: India and Canada

Many of the arguments and much of the research concerning cable bundling is purely theoretical rather than based on empirical data because a truly unbundled cable system has yet to be seen on a large scale in the United States.[52] The international evidence on switching to an a la carte system is also sparse with only India and Canada implementing policies that reflect a true a la carte system on a national scale. Canada announced in October 2013 that they will start to implement regulations for cable debundling,[53] and India currently requires that all cable companies provide an a la carte selection of channels.[54]

India used to have a cable market similar to the current U.S. bundled system—consumers paid a monthly subscription for channels sold as a package.[55] In 2007, India passed the Telecommunication Interconnection Regulation, which made it mandatory for all broadcasters to offer channels on an a la carte basis.[56] After the passage of the Regulation, several broadcasters mounted legal challenges, but the Indian Supreme Court ruled that the Regulation should be implemented because a la carte policy was in the public interest.[57] By 2011, India had a multitude of private companies with a la carte options. But in spite of the Regulation's requirements, the multisystem operators simply do not offer channels a la carte as the law prescribes. Instead, cable operators push add-on channel packages to increase the cost to the consumer.[58] Since many cable companies simply refuse to implement an a la carte program, it is unclear what the ultimate effect of the new Indian Regulation will be on cable prices and consumer choice.

Concerns about cable bundling have also come to light in Canada. Unlike in the United States, Canada's government has already chosen to implement an

52. The Federal Communications Commission (FCC) reports and other economic models are based on theory and speculation. Both the FCC report and the social welfare report use subjective economic modeling.
53. *See Canadian Gov't to Push Cable Providers to Unbundle Channels*, REUTERS, Oct. 13, 2013, *available at* http://www.reuters.com/article/2013/10/13/canada-politics-idUSL1N0I30BW20131013.
54. *See Broadcasters to Give Channels a la carte to DTH Operators: Trai*, INDIANTELEVISION.COM (Sept. 3, 2007, 6:30 PM), http://www.indiantelevision.com/headlines/y2k7/sep/sep28.php.
55. *See id.*
56. *See id.*
57. *See Tdsat Asks Trai to Enforce a la carte Tariff Order*, INDIANTELEVISION.COM (Dec. 11, 2007, 3:30 PM), http://www.indiantelevision.com/headlines/y2k7/dec/dec123.php.
58. *See* Himanshu Kakkar, *Cable Wars*, OUTLOOK BUS. (June 22, 2013), http://business.outlookindia.com/article_v3.aspx?artid=286027.

a la carte system.[59] Fueling this drastic change were Canadian politicians who, like American politicians, believe that an a la carte system would allow citizens to pay only for the channels they watch.[60] One Canadian television executive summed up the issue of government debundling by stating that although the Canadian "government may be well-meaning, . . . they are badly misinformed about how things work in television."[61] Not surprisingly, this sentiment echoes American cable executives' concerns.

Although Canada's federal government recently told cable companies to debundle their service packages, cable companies still have the obstacle of contracting around their content licenses. The Chief Marketing Officer of one cable provider claimed that "almost all" of his content licenses prohibited him from debundling his cable programming.[62] Although the existing content licenses may not be compatible with Canada's aim to break the cable bundle, it is still possible that future negotiations with the content providers will reflect the new policies. Content providers usually negotiate with cable providers about once a year, so they will likely be forced to comply with the Canadian government's demands.

While Canada has mandated that cable companies debundle their services, the free market has already created service providers that offer an a la carte system in Canada.[63] One such company is Eastlink, which unveiled its a la carte system in the summer of 2013.[64] The plan is called "Personal Picks" and offers single digital channel selections beginning at a rate of $2.95 per channel per month.[65] Another interesting feature about Personal Picks is that adding channels to the program can lower the cost per channel.[66] One package includes twelve consumer-selected channels for $1.25 per month while another package includes twenty consumer-selected channels for $1 a month per channel.[67] Additionally, unlike other cable packages, Eastlink allows customers

59. *See* Mandalit del Barco, *Canada Takes Cable A La Carte, But Don't Expect U.S. to Follow*, NPR (Oct. 21, 2013, 4:00 AM), http://www.npr.org/templates/story/story.php?storyId=238899514.
60. *See id.*
61. Terry Pedwell, *Cable TV Bundling: Harper Throne Speech to Outline Pick-and-Pay Mandate*, HUFFINGTON POST CAN. (Oct. 16, 2013, 4:05 AM), http://www.huffingtonpost.ca/2013/10/16/cable-tv-bundling-canada_n_4106256.html.
62. *Id.*
63. *See id.*
64. *See* Bill Power, *Eastlink Signals Demise of Digital Theme Packs*, CHRON. HERALD, Aug. 13, 2013, http://thechronicleherald.ca/business/1147568-eastlink-signals-demise-of-digital-theme-packs.
65. *Id.*
66. *Id.*
67. *Id.* The Canadian dollar is roughly equal to that of the American dollar. At the time of this publication, one Canadian dollar amounted to around ninety-one American cents. *Id.*

to bypass buying a theme pack. For example, instead of buying the entire ten-channel sports package, customers can simply buy the channel devoted to NHL programming.[68]

In order for Eastlink to provide consumers with more flexibility, they negotiated with the content providers for the right to offer single selections of digital channels. Eastlink initially started with a roster of only seventy channels as of August 2013. In order to increase the roster of channels, they will need to negotiate further with the content providers. Rogers, another Canadian media company, previously offered the program in a select area of Canada and claimed that the pick-and-pay pricing scheme was also popular.[69] This experiment lasted only a few months, but there are plans to implement the program full time.[70]

II. BENEFITS AND DRAWBACKS OF A LA CARTE

A. Possible Benefits of A La Carte

1. Social Benefits

One of the main arguments in favor of an a la carte system is that it allows consumers to receive and pay for only programming they truly want. For example, an avid sports fan might want to purchase only the sports channels while a law professor might purchase channels that frequently air Law & Order and other legal-themed programming.

Some public interest groups suggest that the a la carte debate is an issue concerning family values since a la carte programming would allow parents to shield their children from the wiles of cable.[71] The Parents Television Council and other consumer protection groups feel that there is "something fundamentally wrong with requiring consumers to pay for a product they don't want, and may even find offensive, in order to get something they do want."[72] For example, many parents are forced to buy channels that include shows like South Park, which contains adult language, drug references and sexually explicit

68. *Id.*
69. *See* Pedwell, *supra* note 61.
70. *See id.*
71. *See, e.g.*, FED. COMMC'NS COMM'N, REPORT ON THE PACKAGING, *supra* note 17, at 3 ("Others believe that a la carte and themed-tier services may serve as an effective means for the public to address another issue of concern to millions of Americans—the growing coarseness of programming on television.").
72. L. Brent Bozell, III, Founder & President of the Parents Television Council on Cable Choice, Statement of L. Brent Bozell, III (May 5, 2004) (transcript available at http://www.cwfa.org/images/content/bozell-cc.pdf).

jokes. While current technology allows parents to block this type of show, parents are still arguably subsidizing this offensive programming by purchasing the cable bundle.

A la carte programming could both provide the protective parents of young children a tool to combat what they consider low quality programming and have the market effect of increasing the proportion of quality programming.[73] If high cable prices exist because content providers want more money to create more quality content for consumers (and to be paid more in turn for this content), maybe the best course of action is to have an a la carte system where channels with less viewership disappear. Even if the less popular channels vanish, the quality programming from these channels could still find a home on others. For example, during the height of its popularity, Breaking Bad on AMC had 10.3 million viewers.[74] Even if the AMC channel discontinued operation altogether, another channel would almost certainly have picked up such a valuable show, thereby increasing the average popularity of shows on the remaining channels.

2. Potential Economic Benefits

An a la carte system could reduce the content providers' monopoly power since each channel would have to compete individually rather than as part of a bundle. Under the current scenario, each cable bundle effectively competes with other bundles. But by allowing channels to compete individually, less successful channels will most likely phase out. No longer will more popular channels like ESPN carry along with them less popular channels—every channel will stand independently. Content providers will face more difficulty sustaining these less popular channels and will either enhance the quality of the programming or eliminate the channel all together. By eliminating less popular channels that are not profitable, content providers could invest their time and money into creating more popular shows, thereby spending more effort on programming consumers will watch and enjoy at higher rates.

73. *See id.*
74. *See* Rick Kissell, *'Breaking Bad' Finale Soars to Series-Best 10.3 Million Viewers*, VARIETY (Sept. 30, 2013, 11:09 AM), http://variety.com/2013/tv/news/breaking-bad-finale-ratings-1200681920.

B. Potential Drawbacks of A La Carte

1. Potential Social Costs

Although parental concerns are one of the main drivers for an a la carte program, switching to such a system would not necessarily shield children from inappropriate content. Broadcast television also has its share of raunchy material, from Family Guy often showing characters engaging in sexual activity to the reality show dalliances of The Bachelor. Additionally, one of the biggest snafus in television history—Janet Jackson's Super Bowl halftime wardrobe malfunction—occurred on network television, not on cable.[75]

Another potential social cost involves consumers have indefinite or incomplete preferences, and the difficulty of projecting their future preferences. For example, consumers might not realize how often they actually view certain channels. Some people might forgo buying the sports package if they do not watch sports often, but once a big game arises later in the season, they might miss it if they did not subscribe to a particular channel. Similarly, cable viewers will almost certainly be less likely to sample new shows on channels to which they do not subscribe because they will not have access to those shows without paying an additional fee.

2. Potential Economic Costs

While there are multiple reasons why an a la carte system might cause prices to rise even higher, the primary reason includes cable operators wanting to maximize profitability during decreased consumption. An a la carte pricing system would endanger cable operators' revenue stream because people would likely purchase fewer channels.[76] In order to maximize the profitability of such distribution, the cable companies would likely need to increase their prices per channel, if offered on an a la carte basis.[77] For example, a cable provider who used to provide a hundred channels for a hundred dollars under the cable bundling system would do everything in its power to maximize profits under the a la carte pricing. But under the a la carte system, if the cable providers truly

75. *Apologetic Jackson Says 'Costume Reveal' Went Awry: FCC to Investigate Incident at End of Halftime Show*, CNN.COM (Feb. 3, 2004, 7:58 AM), http://www.cnn.com/2004/US/02/02/superbowl.jackson.

76. *See* Hazlett, *supra* note 17, at 285.

77. *See id.*

pro-rated the channels by charging only one dollar per channel, their revenue would almost certainly plummet. Instead of pro-rating, it is likely that cable companies would increase the price of each channel offered.[78]

Switching to an a la carte system also increases transaction costs to both the cable providers and consumers. Cable providers will experience increased transaction costs as a result of having to negotiate with the content providers over each individual channel.[79] The costs associated with information gathering and negotiation would be much higher than if the cable provider engaged in only a single negotiation for each content provider. Additionally, cable providers would have to increase operational expenses for equipment and infrastructure, customer service operations, and billing and office support.[80]

Consumers themselves will also likely experience higher transaction costs because they do not necessarily know what channels they might like unless they are already exposed to them. Under the current cable bundle model, users can simply flip through channels to see what their preferences are. But under the a la carte model, consumers will have to spend time tailoring their package in order to ensure that all of their viewing needs are met. Currently, the process of deciding what cable packages to purchase might take a consumer five to ten minutes, whereas selecting individual channels from a set of more than one hundred could take hours.

While the transaction costs on the consumer and the cable company will rise, content providers will most likely experience the highest increase in transaction costs.[81] This is because marketing costs will rise to gain the number of subscriptions necessary to sustain a profit. Currently, networks that are sold on an a la carte basis "spend a significant amount of their revenue marketing themselves to consumers."[82] Under an a la carte system, content providers who were under the bundle system would spend more money to gain customers. Some argue that this increase in marketing costs would then be transferred onto the consumer.[83] And if companies start charging more per channel under an a la carte system, it is likely that far fewer customers will subscribe to any given channel. Therefore "the loss of cost savings, combined with the loss in

78. *See id.*
79. *See* Gregory S. Crawford & Ali Yurukoglu, *The Welfare Effects of Bundling in Multichannel Television Markets*, 102 AM. ECON. REV. 643 (2012).
80. FED. COMMC'NS COMM'N, REPORT ON THE PACKAGING, *supra* note 17, at 6.
81. *See id.* at 6.
82. *Id.*
83. *See, e.g.*, Crawford & Yurukoglu, *supra* note 79, at 643 ("We estimate that negotiated input costs rise by 103.0 percent under à la carte. These higher input costs offset consumer benefits from purchasing individual channels." (emphasis omitted)).

advertising revenue and the likely rise in license fees to compensate such losses, may cause many program networks to fail, thus adversely affecting diversity."[84]

Although the marginal cost to the cable company of providing one additional channel is very low, there are generally fixed costs in providing cable service at all. For example, cable companies need to hire salespeople, customer service, and maintenance people who go out and install the cable equipment. The company also has to pay for the cable box and DVR, if applicable. All of these expenses are high, but when divided by the number of channels provided to consumers nationwide, the expenses are fairly low. Thus, this cost may be a relatively small percentage of an individual consumer's total cost when spread out over a hundred-channel bundle, but if a customer only wants three channels, this cost will raise the price by a much larger percentage.

III. HOW AND WHEN SHOULD THE GOVERNMENT REGULATE?

Government attempts to curb the cable bundle may be a poor solution to the rising cable bill since forcing cable providers to "offer" channels a la carte could cause cable prices to increase at exorbitant rates.[85] In an effort to make prices lower, government regulation may have the unintended effect of increasing prices to consumers.

A. Letting the Market Naturally Gravitate Toward A La Carte

The research and background of the cable bundling model is speculative and there does not seem to be one definitively right answer. While the vast majority of studies seem to suggest that mandating an a la carte type program would increase cable bill prices and cause less consumer choice, other studies (even one by the FCC) suggest otherwise.[86] Considering that experts as a whole are uncertain about what the best model for cable should be, it may be best to simply let the market sort out any potential inefficiencies over time.

In addition to offering individual channels, an a la carte model can be extended even further by only offering specific shows, or even episodes. Many online viewing forums already engage this way. For example, Amazon allows customers to buy specific shows, and in many instances particular episodes of

84. FED. COMMC'NS COMM'N, REPORT ON THE PACKAGING, *supra* note 17, at 6.
85. *See id.*
86. *See, e.g.*, *id* at 7.

shows.[87] This model is frequently used when a customer has already seen the first or second season of a series and would like to purchase a particular season or episode that the customer may have missed. Additionally, private companies in Canada like Eastlink are already sprouting and arguably incorporating an a la carte system more efficiently than if such a system had been regulated by the government.[88]

B. Regulation May Decrease Consumer Choice

In an effort to increase consumer choice, the effect of government intervention may paradoxically be decreased choice. As stated earlier, one likely effect of unbundling legislation would be the demise of the least popular channels and the consolidation of the most popular programming onto the most popular channels. This will necessarily lead to a decrease in overall programming options available to consumers.

Although consolidation of popular programming into a narrower range of popular channels might be seen as beneficial, it could have the effect of killing off socially valuable but niche and relatively unpopular channels and shows. For example, many viewers may be unwilling to pay for much of the educational programming on the History or Discovery channels, but they may nevertheless watch the programming from time to time when included in a cable bundle. These channels, which could be at risk of dying under an a la carte system, may contribute to a better-informed public under the current bundling system. Similarly, it is possible that parents may not fully consider their children's viewing preferences when choosing what individual channels to purchase; but channels that provide educational and interesting children's programming may provide large social benefits. A bundling system that includes children's programming avoids this problem.

An a la carte regime, therefore, may ultimately decrease cable viewers' options as a result of the decisions they made when subscribing to individual channels. The extent of this effect is uncertain. It is possible that consumers will do their research and purchase exactly the channels airing the quality programming that they will want to view in the future. But another possibility

87. *See* Sam Byford, *Amazon's Prime Instant Video '17,000 Movies and TV Shows' Counts Individual Episodes*, THE VERGE (Apr. 13, 2012, 12:01 AM), http://www.theverge.com/2012/4/13/2945267/amazon-prime-instant-videos-17000-counts-tv-episodes ("Amazon has confirmed that the figure of 17,000 movies and TV shows cited for its Prime Instant Video service refers to individual streaming items, not titles. This means that TV shows have their individual episodes weighted as heavily as single movies, of which there are only 1,745 . . . .").

88. *See* Power, *supra* note 64.

is that consumers will be relatively uninformed in their decision making processes and purchase only the most popular and well-known channels to the exclusion of others that may have been highly valuable if they had done more research.

C. Does Consumer Willingness to Pay Demonstrate Value?

Households subscribe to cable if, and only if, the value they place on cable exceeds the retail price. Thus, consumers that remain subscribed to cable packages continue to value those packages at higher than the retail price. One economist commenting on this issue stated that, "[e]ffectively, the consumer subscribes to realize their individual preferences, and the cable company tosses in the additional channels for free. The practice is highly efficient. It dramatically reduces transaction costs and it prices marginal viewing choices at zero—exactly their marginal cost."[89] Other economic writers have expressed similar views.[90] Under this theory, consumers are not paying for the entire bundle, but only for the channels they want to watch. Despite its counterintuitive nature, this theory is well-reasoned as to channel distribution because as described above, the marginal cost to the cable company of providing a customer with an additional channel is effectively zero.[91]

D. Parties Other Than Cable Companies Contribute to High Costs

Considering that the reason why cable companies have to bundle is to keep content providers happy, it is possible that the problem may lie with the content producers. Viacom owns many popular networks such as Comedy Central, MTV, and Nickelodeon. But it also owns many less popular channels such as MTV2. Despite MTV2's low viewership, eighty-one million U.S. homes receive MTV2—roughly 71 percent of all American households who purchase cable.[92] The cost of creating content for MTV2 is not free. Viacom must offset its programming cost for MTV2 by increasing its revenue. While this revenue can come from advertising, it also largely comes from the

89. Hazlett, *supra* note 17, at 257.
90. *See, e.g.*, Yglesias, *supra* note 15 ("If you subscribe to basic cable and just four channels represent 95 percent of your viewing, then by definition what you're paying for is *access to those four channels*.").
91. One potential criticism of this theory is that it ignores the fixed cost to the content providers of producing content for the additional channels as well as the subsequent fixed cost to the cable providers of purchasing the additional channel. Arguably, under an a la carte system, many channels included in cable bundles would cease to exist, which would reduce overall costs.
92. *See* Sherman, *supra* note 10.

cable providers who pay Viacom for its channel package. Since cable companies must carry all of Viacom's channels and not just the popular ones, they must bear at least a portion of the increase in Viacom's costs.[93] This cost is ultimately transferred onto consumers' cable bills.

In fact, one cable company, Cablevision Systems Corp., filed suit against Viacom in 2013 because Cablevision did not want to pay for channels with low viewership.[94] Cablevision attempted to do exactly what consumers are advocating: pay only for the channels actually desired. It is currently estimated that Cablevision pays $38.8 million a year for fourteen channels it does not want and only $76.8 million a year for the channels it does want.[95] Cablevision claimed that Viacom wanted nearly $1 billion dollars if the cable company refused to pay for the low-rated channels.[96] Instead of paying for channels like MTV2, Cablevision only wanted premium channels like Comedy Central, MTV, and Nickelodeon that drive revenue.[97]

Previously, Cablevision signed a long-term agreement to carry Viacom's networks, which were estimated to cost over $115 million a year.[98] Cablevision also claimed that these lower-rated shows were siphoning off bandwidth from channels that were more popular and from new experimental channels.[99] For example, Cablevision would like to launch other experimental channels such as Magic Johnson Enterprises' ASPiRE, Retirement Living TV, and foreign language channels.[100] Viacom, on the other hand, wanted Cablevision to pay for a plethora of channels in which Cablevision was not interested. Cablevision argued that by broadcasting Viacom's less popular channels, it was effectively barred from broadcasting other networks and shows that might ultimately prove to be more popular.

93. *See id.*
94. *See* Amended Complaint at 1, Cablevision Sys. Corp. v. Viacom Int'l Inc., No. 13 Civ. 1278 (S.D.N.Y. July 16, 2013).
95. Jonathan Stempel, *Cablevision: Viacom Made $1 Billion Threat Over Bundling*, REUTERS, Mar. 7, 2013, *available at* http://www.reuters.com/article/2013/03/08/us-viacom-cablevision-idUSBRE9261DR20130308 ("SNL Kagan, which tracks cable fees, has estimated that Cablevision pays $38.8 million a year for the 14 channels it does not want, and $76.8 million a year for the eight it wants.").
96. *Id.* ("Cablevision Systems Corp is claiming that Viacom Inc sought to extract a nearly $1 billion penalty if it refused to pay for low-rated channels it did not want in order to access more popular channels such as Comedy Central, MTV and Nickelodeon.").
97. *See id.*
98. *Id.*
99. *See id.* ("Cablevision said this 'bundling' arrangement, also known as a 'tying agreement,' sapped bandwidth it could have used for other channels from other programmers.").
100. *Id.*

E. How Should the Government Regulate, If It Must?

If the government decided to intervene with the goal of reducing inefficiencies in the market, they should aim to regulate the content providers like Viacom rather than cable providers. After all, cable providers in Canada, where the government has already announced a la carte regulations, worry that they will still be held accountable to the content providers.[101]

Forcing cable companies to stop bundling may not solve the problem since the cable companies would still have to find a way to battle the content providers who want to bundle and get around the predicted increase in cable prices. Simply banning cable bundling would not necessarily make cable prices more affordable due to the economic models previously described. It is likely, however, that banning bundling would give the cable companies the upper hand when negotiating with content providers because content providers would be unable to demand bundling if it is illegal.

Another alternative may be to discourage content overproduction through the use of tax incentives. For example, the government could add a small charge (say, between ten and fifty cents) per channel to the consumer's cable bill. Such a tax would discourage cable companies from providing massive cable bundles because consumers would be unlikely to pay the tax on a large number of channels they don't want to watch. This would be a particularly attractive option if policymakers conclude that the production of low-quality programming for unpopular channels largely drives cable costs. The per-channel tax would provide a large incentive to consolidate quality programming into a smaller number of channels that would draw higher ratings. Simultaneously, it is likely that less popular channels such as MTV2 would be discontinued.

IV. FUTURE OF CABLE: SIGNS THAT AN A LA CARTE WORLD ALREADY EXISTS

The government might no longer need to regulate cable providers because cable prices will decline in the near future anyway due to viewers switching from cable to internet viewing alternatives like Netflix and Hulu.[102] In November 2013, the television industry reported its worst twelve-month

101. *See Canadian Gov't to Push Cable Providers to Unbundle Channels*, REUTERS, Oct. 13, 2013, *available at* http://www.reuters.com/article/2013/10/13/canada-politics-idUSL1N0I30BW20131013.
102. *See* Jim Edwards, *TV Is Dying, and Here Are the Stats to Prove It*, BUS. INSIDER (Nov. 24, 2013), http://www.businessinsider.com/cord-cutters-and-the-death-of-tv-2013-11.

stretch; such statistics, along with the rise of Netflix and Hulu subscriptions, seem to support this idea.[103] Despite the decline in cable television subscriptions, 90 percent of American households continue to pay for a cable package.[104] But the continuing loss of cable customers could shift costs onto the remaining consumers who are paying higher prices for television channel bundles and high-speed internet access.[105] Cable prices would likely decrease in an attempt to retain viewership once the demand for cable dramatically declines.

This decline in cable subscriptions could be another argument to the effect that the market is already working to provide customers what they truly want. In January 2013, roughly a quarter of U.S. televisions were connected to the internet, making it easier for consumers to watch shows on internet-based content providers like Netflix, Hulu, and HBO Go.[106] By the end of 2013, this figure is expected to rise to 30 percent, which represents 35.1 million U.S. households.[107] It is also expected that at least one person in each household will use the internet on that television on a monthly basis.[108]

Accordingly, in this world of cable bundling, a growing contingency of consumers are nevertheless living in their own a la carte paradise. This group mainly consists of members of a younger generation for which Netflix and Hulu are increasingly the main source of entertainment.[109] This generation demands, and largely receives, high quality programming at an affordable price. Major networks like HBO have tried to jump on this a la carte trend by offering HBO Go, which allows customers to watch specific shows on demand. But while Nielsen is indeed reporting a decline in television viewership among America's younger generation, as of September 2013 the decline has not been dramatic, and there are still millions of viewers glued to cable television.[110]

103. *See id.*
104. *See* NIELSEN, CROSS-PLATFORM REPORT Q3 2011 (2012), *available at* http://www.nielsen.com/us/en/reports/2012/cross-platform-report-q3-2011.html.
105. *See* Edwards, *supra* note 102.
106. *See eMarketer: A Quarter of US Households Now Have a TV Connected to the Internet*, EMARKETER (Jan. 3, 2013), http://www.emarketer.com/newsroom/index.php/emarketer-quarter-households-tv-connected-internet/#VxFBKFBSTA1LmtL0.99.
107. *Id.*
108. *Id.*
109. *See* Edwards, *supra* note 102.
110. *See Are Young People Watching Less TV?*, MARKETING CHARTS (Mar. 10, 2014), http://www.marketingcharts.com/wp/television/are-young-people-watching-less-tv-24817.

CONCLUSION

The best course of action for policymakers to address the cable bundle is likely to do nothing, sit back, and wait and see what happens next in the rapidly evolving media landscape. Despite the widespread concern over the rampant practice of cable bundling, evidence that the current market is significantly worse than it would be under proposed a la carte regulations is scarce. Government intervention could just as easily reduce efficiency as promote it. And if the much maligned bundle is truly inefficient, new media platforms such as Netflix, Hulu, and HBO Go will likely necessitate a change in the cable market sooner rather than later.