

3 Legal Challenges Facing Pay-TV Business Models

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Pay-television is evolving at a breathtaking pace. The change is coming not only from “disrupter” strategies like Apple TV and YouTube Red, but potentially from a slew of lawsuits challenging fundamentals of existing television distribution businesses. For example, at the same time that cable and satellite companies are moving to abandon set-top box delivery altogether and the Federal Communications Commission overhauls its failed initiative to create a retail set-top box market, subscribers are suing over alleged “tying” of premium cable service and set-top boxes.[1] Similarly, at the same time the NFL is live-streaming games on Yahoo! and NFL Sunday Ticket is being offered in multiple, standalone packages, football fans and sports bar owners are piling on renewed lawsuits attacking NFL Sunday Ticket.[2]



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This article examines recent cases that have the potential to impact the very core of the pay-television business — bundled “packages” of channels — and the implications for the industry as it embraces new entrants and new technology.

Freeze Frame: Are Consumers Guaranteed a Specific Channel Bundle?

Channel bundling is a defining characteristic of the modern pay television business. Distributors must offer a “lifeline” tier of basic programming. On top of that, distributors sell bundles of channels — e.g., Digital Starter (Comcast Corp.) or America’s Top 120 (Dish Network Corp.) — and compete for subscribers based, in part, on the pricing and content of their packages.

Various constituencies claim channel bundling inflates monthly pay-TV bills and gives broadcasters outsized leverage in negotiations with distributors. But economic studies suggest consumers would pay more, not less, in an a la carte model.[3] And the FCC staff twice looked at the issue and came to opposite conclusions on the benefits of a la carte models. Congress has been unpersuaded by Sen. John McCain, R-Ariz., to mandate a la carte offerings.

Direct litigation attacks on distributor channel bundling have also failed. In *Brantley v. NBC Universal Inc.*, pay-TV subscribers claimed that channel bundling by programmers and, in turn, by distributors violated Section 1 of the Sherman Act.[4] The claims were rejected because there was no evidence that channel bundling limited competition either “upstream” for program production and licensing or “downstream” for pay television services to consumers.

Now, the Eighth Circuit is set to hear a case raising a new, indirect, challenge to channel bundling. In *Stokes v. Dish Network LLC*, a putative class of subscribers claims Dish breached its contractual and other obligations by allowing contracts with Turner and Fox to expire in late 2014. Turner and Fox channels went “dark” on Dish for three to four weeks each. The Stokes plaintiffs claim that they (and more than 8 million other Dish subscribers) are owed a refund because the outages allegedly deprived them of the full bundle of programming they purchased. So far, the Stokes court has agreed with the plaintiffs. It held that, if Dish’s standard subscription contract allowed Dish free reign to eliminate or switch channels within a package (as Dish argued), the agreement would be wholly one-sided and “illusory.” [5] The court rejected Dish’s argument that Dish’s actual, partial performance (i.e., continuing to make hundreds of other channels available) saved the contract. Instead, the court reasoned that Dish has an implied contractual duty of good faith and fair dealing to provide monetary credits to subscribers for the “lost” programming.

If upheld, the district court’s reasoning in *Stokes* could make channel bundling a riskier structure for distributors, especially as retransmission and renewal negotiations become ever more contentious and outages more frequent. Likewise, the Stokes approach could increase the leverage of popular broadcast and cable networks in negotiations. Any change to an existing programming bundle — including any outage due to unresolved retransmission or renewal negotiations — could, like a stock-drop, trigger a lawsuit. And not just any lawsuit, but a nationwide, putative class action seeking millions of dollars in damages (unless an enforceable arbitration and class action waiver provision is in place).

Indeed, *Stokes* is the third in a string of “broken bundle” cases. One went to verdict for the plaintiffs in 2014 and is set for retrial depending on the Eighth Circuit’s decision in *Stokes*. [6] Another was dismissed on a ruling that subscribers have no contractual right to any particular bundle of programming and that limitations on liability for programming changes are not “unconscionable,” but, at best, “impolite.” [7] That ruling was never appealed. Thus, the Eighth Circuit’s decision in *Stokes* will set the stage for whether distributors will have to worry about potential consumer claims for failed contract negotiations or package restructuring choices.

Package Deal: Antitrust Challenges to Programmer Bundling

Although the Ninth Circuit rejected antitrust claims challenging distributor level channel bundling in *Brantley*, one of the distributors, Cablevision, successfully alleged claims in New York challenging channel bundling at the programmer level. [8] The October 2015 settlement in *Cablevision* leaves several critical issues untested and unreviewed that may impact future antitrust claims as the pay-TV industry evolves.

First, what is a plausible market definition for video content and what are legitimate indicia of distinct markets? *Cablevision* allowed claims to proceed on relevant markets as narrow as a single channel (Nickelodeon, Comedy Central, etc.) based on alleged consumer demand for the particular content. But most valuable content is exclusive to whatever network produces it, just as a brand is exclusive to its owner, and continues to be produced because it is responsive to some consumer demand. Without more rigorous analysis, “single channel” product markets threaten to collapse the distinct issues of market definition and market power and penalize competitive success — e.g., better programming.

Second, market definitions driven principally by relative popularity of content could be particularly troubling in the video industry where most content is sold in some “bundled” form — a bundle of episodes in a season, a bundle of programs on a channel, a bundle of channels on a service, etc. — and where each bundle consists of more and less popular pieces. Antitrust tying claims become possible

when the bundle can be broken out into distinct product markets — the “tying” and the “tied” products. In Cablevision, the bundle of Viacom affiliated channels was alleged to break down into “tying” and “tied” channels principally based on popularity. As linear viewing gives way to binge releases, on-demand episodes, and minutes-long clips, antitrust plaintiffs may seek to attack more bundled sales forms as unlawful “tying” of “popular” content to less compelling, “general” viewing.

Third, Cablevision appeared to revive “block-booking” as an antitrust violation. Cablevision argued that “block-booking” is largely identical to tying (requiring two distinct products, market power in the “tying” product, coercion or forced purchase of the “tied” product, and the involvement of substantial interstate commerce in the “tied” market). But unlike tying claims that may be dismissed where there is “zero foreclosure” in the “tied” market (i.e., the plaintiff was only forced to buy a tied product it otherwise would not have bought at all), “block-booking” allegedly allows a finding of foreclosure because the buyer/licensor is required to exhibit the tied content, using up a screen, channel, or other means of exhibition for which other content could have competed but for the block-booking. If block-booking claims are sustained on this theory, they could potentially lower the bar even further for antitrust challenges to various forms of bundled video licensing.

Fair Play: FCC Program Carriage Disputes

At the core of the net neutrality debate is the question of whether and how much the FCC can regulate the “pipes” to protect a robust and diverse flow of content. That debate has a precursor in the 1992 Cable Act and the FCC’s “program carriage” regulations. Among other things, the Act and the regulations prohibit distributors from discriminating against programmers “on the basis of affiliation or nonaffiliation” where the effect is “to unreasonably restrain” the ability of the programmer to “compete fairly.”[9]

To date, program carriage proceedings have been rare, time-consuming and, for programmers, unsuccessful. For the most part, those proceedings have challenged one-off decisions where there was no direct evidence of discrimination and no pattern of favoritism. But as distributors continue to shuffle, slim down, and repackage their programming, more and more programmers may have incentive to challenge their placement on or removal from a particular service or tier.

Currently, for example, two programmers (The Tennis Channel and Game Show Network) are challenging decisions by, respectively, Comcast and Cablevision to keep or place the channels on higher-cost, less widely subscribed “sports tiers.”[10] While each channel is a relatively minor player, the parties have invested years in the proceedings, with full-blown party discovery, multiple economic and other experts, and a multi-layered process (prima facie determinations by the Media Bureau, trial before an FCC ALJ, review by the FCC, and further review by a circuit court of appeals). Indeed, in the case of the Tennis Channel, the programmer has asked the FCC (and now the D.C. Circuit) to reopen proceedings after the D.C. Circuit found Tennis Channel failed to prove discrimination the first time around.

Likewise, the more decisions distributors make about retiering or removing channels, the more potential there may be for programmers to compare how a distributor chose to make which decisions and how it treated affiliated and non-affiliated channels in any system restructuring. As distributors restructure their packages, they may also be engaged in more discussions of potential “swaps” with other distributors where each agrees to carry the other’s affiliated network. The pending Game Show Network proceeding raises the issue of whether the proposal of a swap constitutes or is evidence of discrimination based on affiliation.

Conversely, programmers may have an increasingly difficult time proving that any individual distributor's decision has a sufficiently adverse effect on the programmer's ability to "compete fairly." Some insist that the First Amendment permits interference with carriage decisions only when a distributor has market power in a relevant geographic area.[11] If that approach prevails, programmers may have a difficult time carrying their burden. The courts and the FCC have observed that the competitive mix of distributors has dramatically improved since the 1992 Cable Act.[12] If, however, program carriage standards depart from Sherman Act cases to consider the effect on the individual programmer,[13] or shift the burden to allow a distributor to show its discrimination is justified by pro-competitive effects,[14] programmers will have a reasonable opportunity to combat unjustified discrimination. The D.C. or Second Circuit may take the opportunity to rule on the competitive effects standard either in the Tennis Channel or Game Show Network proceeding.

The Wrap-Up

The pay-television industry operates in the midst of two key, legal principles: (1) the law should interfere as little as possible with business decisions about whether and how to bundle its products and services, but (2) intervention is appropriate when a robust market for the creation and delivery of diverse content is at risk. As the industry adapts to new competitive pressures, new technologies and new consumer expectations, programmers and distributors will continue to examine existing bundled model and experiment with new ones. A critical question will be how the courts and the FCC balance competing interests in allowing flexible bundling, but protecting against abuse. Stay tuned.

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[1] E.g., *In re Cox Enter., Inc. Set-Top Cable Television Box Antitrust Litig.*, 12-ML-2048-C (W.D. Okla.); *In re Comcast Corp. Set-Top Cable Television Box Antitrust Litig.*, 09-md-2034 (E.D. Pa.).

[2] *In re National Football League's "Sunday Ticket" Antitrust Litigation*, MDL No. 2668 (comprising more than twenty lawsuits). In 2001, a settlement was entered in a prior class action alleging that NFL Sunday Ticket violated the antitrust laws. *Schwartz v. Dallas Cowboys Football Club, Ltd.*, 2001 WL 1689714 (E.D. Pa. 2001).

[3] E.g., Gregory S. Crawford and Ali Yurukoglu, "The Welfare Effects of Bundling in Multichannel Television Markets," *The American Economic Review*, Vol. 102, No.3, June 2012.

[4] 675 F.3d 1192, 1195 (9th Cir. 2012).

[5] *Stokes v. DISH Network LLC*, 2015 WL 4378217 (W.D. Mo. July 15, 2015).

[6] *Padberg v. DISH Network LLC*, 11-cv-04035-NKL (W.D. Mo.).

[7] *McClamrock v. DISH Network LLC*, 2011 WL 7430006 (N.D. Ga. 2011).

[8] *Cablevision v. Viacom*, 2014 WL 2805256 (S.D.N.Y. 2014).

[9] 47 U.S.C. § 536(a); 47 C.F.R. § 76.1301.

[10] *The Tennis Channel, Inc. v. FCC*, 15-1067 (D.C. Cir.); *Game Show Network v. Cablevision Sys. Corp.*, MB Dkt. No. 12-22, CSR 8529-P.

[11] E.g., *Comcast Cable Comm. v. FCC*, 717 F.3d 982, 991 (D.C. Cir. 2013 (Kavanaugh, J., dissenting)).

[12] See, e.g., *Concerning Effective Competition: Implementation of Section 111 of the STELA Reauthorization Act*, 80 Fed. Reg. 38001 (July 2, 2015) (adopting rebuttable presumption that cable operators face “effective competition” in every market area); *In re Revision of the Commission’s Program Access Rules*, 27 FCC Rcd. 12605 (F.C.C.) (Oct. 5, 2012) (allowing per se prohibition on exclusive cable programming licenses to sunset given increasingly competitive market); *Cablevision Sys. Corp. v. FCC*, 597 F.3d 1306, 1314 (D.C. Cir. 2010) (strongly suggesting that FCC should allow exclusivity ban to sunset). .

[13] E.g., *Wealth TV*, 2011 WL 2324320 at ¶¶ 16-17; *In re Tennis Channel, Inc. v Comcast Cable Comm., LLC*, 27 FCC Rcd. 8508, ¶¶ 40-43 (FCC Jul. 24, 2012).

[14] E.g., *Time Warner Cable Inc. v. FCC*, 729 F.3d 137, 166 (2d Cir. 2013).
