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Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992	))))	MM Docket No. 92-262
Tier Buy Through Prohibitions	)	

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Introduction

Cole, Raywid & Braverman submits these Comments on the Commission's proposed buy through regulations, on behalf of the undersigned cable operators and associations.

Summary

Many systems are not addressable, and even subscribers of an addressable system who do not subscribe to premium channels have no addressable box on premises, or have one only on selected TV sets. Thus, the costs of making a tier "addressable" is substantial in both non-addressable and addressable systems. Existing traps remove both tier and premium signals, making trapping an ineffective device to permit basic subscribers to "buy around" the tier. Tier scrambling creates very significant customer and business burdens, including an unwelcome complication of TV and VCR features and costly investment in analog technology soon to be made obsolete by digital. Channel realignment to facilitate trapping solutions create similar burdens, including significant limits on future program additions and a perceived handicapping of tier viewship.

The Commission should therefore adopt a rule exempting from the tier buy through prohibition any system which does not scramble all tier channels; and permitting the recovery of converter costs from subscribers who buy around the tier in fully addressable systems.

The corollary discrimination rule should not proscribe installation, package, and similar discounts. These offer genuine subscriber savings, are an essential part of cable marketing, and are commonly accepted in service industries.

Comments

I. ENGINEERING OF "ADDRESSABLE" SYSTEMS

A. A Substantial Number of Systems Are Non-Addressable, And Use Traps to Configure Service Offerings

"Addressability" refers to the ability of a cable system to authorize or deauthorize services to individual subscribers' converters from a remote (headend or hub) location by computer communication.

The deployment of addressability varies from operator to operator, but most MSOs have a substantial number of subscribers served from non-addressable systems. For example, approximately 26% of Jones' systems have no form of addressability in place. In those systems, a subscriber is authorized or deauthorized for satellite tier service or premium (pay or pay-per-view) service by dispatching a truck and installing or removing filters and/or traps and/or non-addressable converters which prevent or permit particular frequencies (channels) from passing through to the TV receiver. Because satellite tier services remain very popular, even among households which do not subscribe to premium services, "tiers" are trapped out only in a relatively small percentage of homes.

B. The Costs of Installing and Operating An Addressable System Are Substantial

A system is made addressable by the installation of equipment at the headend and the installation of an addressable converter at each addressable subscriber location. Typical costs are substantial. For example, installation of a controller at the headend averages $30,000 to $50,000. Each scrambled channel must be encoded, at approximately $2,000 per channel. Billing computer software (to interface with the controller) for five years costs $50,000. In addition, modems and communications lines need to be established between the headend and the billing computer (e.g., CableData), at approximately $1,000, plus monthly line charges for about $10,000 for 5 years. Addressable boxes cost between $105 and $150 per converter, plus the cost of installation, typically $35-$50 per dispatch. Because of the prevalence of additional outlets, more than one converter is needed per home, plus an allowance for converters in inventory and under repair. For example, for Jones alone to make all of its homes addressable would cost more than $123 million, without accounting for additional outlets or inventory. For Western to deploy addressable converters universally would cost $29 million in equipment costs; $9.5 million in installation costs; plus $4.0 million for additional outlets and inventory. This is more than twice Western's average annual capital for all seven systems. The burden on smaller operators can be even more dramatic, when compared to the subcriber base. OCB estimates a cost of $1.2 million to go addressable for its 5,000 non-addressable subscribers.

C. Common Satellite Tier Traps Used on Addressable Systems Frequently Preclude the Delivery of Premium Signals to Subscribers Who Do Not Receive the Satellite Tier

1. Not All Subscribers on "Addressable" Systems Receive Addressable Converters

To continue with the Jones example, approximately 74% of Jones' cable systems have some form of addressability in place, but not all channels are scrambled and not all subscribers require addressable boxes. This is because the most common method for deploying addressability is to "scramble" only premium and pay-per-view programming services and place addressable boxes in the homes of premium and PPV subscribers. In such a system, only premium subscribers are "addressable," and only on sets receiving the premium services. Although national pay penetration is normally reported at 78%, "pay penetration" is expressed as pay units per basic cable household. A household subscribing to two pay services counts as two pay units. Thus, the number of basic households receiving pay services is less than 38%. For example, Columbia has a pay unit "penetration" of 79%, but less than half of homes receive pay services. Columbia has 222,000 subscribers on "addressable" systems, but only 150,000 have addressable converters. Of Western's 318,000 subscribers, 317,000 are served from addressable headends, but only 60,000 (19%) have addressable converters in their homes. While 74% of Jones' systems have addressability, only 40% of subscribers have addressable boxes. Thus, in most "addressable" systems, a substantial number of subscribers are not "addressable."

Among those non-premium subscribers on an addressable headend, those electing not to receive satellite tier services are handled exactly as would be any nonaddressable subscriber on a nonaddressable headend: a truck is dispatched, and traps and filters are installed. The cost of traps varies considerably among systems and among channel configurations. However, a typical loaded cost of installing traps and filters is $40.00 per incidence, but costs can be considerably higher.

2. Common Satellite Tier Traps Remove Both Satellite Tier Signals And Premium Signals Carried on Upper Channels

However, in most addressable systems, the channels have been aligned so that "basic" signals are in the low band, satellite tier signals are above them, and premium signals are placed on various channels within the satellite tier band. The traps and filters installed to remove satellite tier signals for a basic-only subscriber also filter out and remove all premium signals (including "addressable" pay signals) in the satellite tier band. For example, all of Western's basic-only customers are served by traps which also filter out all premium services, although those premium services are "addressable."

Some cable systems have a different channel position for one (usually older) premium service. For example, HBO might be trapped on Channel 3, and all other premium services "scrambled" on upper channels. For such systems, a "basic only" subscriber who wishes to buy HBO without tier could physically be accommodated by dispatching a truck and removing the trap from Channel 3; but that subscriber could not buy Showtime without tier, because the filter used to remove tier channels also removes the "addressable" Showtime channel.

3. Scrambling All Satellite Tier Signals Creates Customer And Business Burdens

There are several reasons that cable operators refrain from scrambling satellite tier signals.

1. Scrambling creates the need for a converter, which disables many functions (e.g., remote control) on a customer's TV set. This is generally unwelcome by our customers. For example, when the Vancouver, Washington system scrambled all channels pursuant to local requirement, there was a customer outcry. Even after Columbia descrambled "basic" channels in 1992, many customers returned the addressable converters to resume use of functions on their TV receivers.

2. Scrambling increases the "lockup" time on each channel, adding 3/4 to 1 second to the time it takes for a viewer to see a channel as he surveys what's on television.

3. Scrambling increases the problems in taping one channel while watching another.

4. Economics and technology have changed the industry's business plans. Four years ago, the goal of many operators was to place an addressable converter in every home to permit channel mapping and pay-per-view sales. With digital/compression technology advancing rapidly, most are reluctant to invest in more analog addressable converters. For

example, Jones' 93,000 subscriber Albuquerque system is addressable, with a pay-to-basic ratio of 68% -- but only 4,800 homes have addressable boxes. Analog boxes are distributed only on an incremental "as requested" basis.

5. Z-TAC converters deployed in the early 1980's have only eight levels of addressable codes, which will not accommodate scrambling all signals on satellite tier as well as pay and pay-per-view services. Thus, Jones cannot scramble satellite tiers even in many of its "addressable" systems without upgrading or replacing all existing converters. Western would incur costs of $6 million to replace such existing converters in five of its systems.

4. Realigning All Signals Creates Customer And Business Burdens

There are also several reasons why cable operators are reluctant to realign channels to place all premium services above basic and move satellite tier services up, to permit "trapping" solutions to buy through.

1. A "one time" realignment in this way severely restricts the ability to add premium services, additional "multiplexed" pay services, or pay-per-view services in the future.

2. Channels 18, 19 and 20 are prone to interference

from taxicabs and other mobile users. Typically, low value networks are placed on those channels -- not premium channels. Premium services are located on the cleanest possible channel because the slightest interference may cost us a customer for that single-channel product.

3. Realignment requires visits to subscriber homes to reconfigure VCRs for home recording. In our experience, 25% of all homes require service calls for VCR hookup.

4. Installation of either negative or positive traps requires home visits. Positive traps need to be installed at the tap point or ground bloc, to make permitted signals available to all TV sets. Negative traps require visits to every trap and pedestal of basic only customers.

5. Using multiple traps (e.g., trapping the tier and three pays to allow the sale of one pay) increases the potential for signal leakage. In addition, bundles of multiple traps, which cannot easily be connected directly to the tap port, are more prone to theft of service.

6. Positive traps cannot be placed on all channels; creates signal loading problems. They may also create interference on adjacent channels.

7. There is a persistent view among some advertisers and networks that a higher channel position reduces viewership.

If cable is expected to earn most of its profits from cable programming services, we are reluctant to handicap our future in this way.

Present channel alignments have been selected to minimize these problems.

The cost of realignment is substantial. Jones recently realigned channels to launch "broadcast basic" at a cost in excess of $2 million. But the cost for particular systems can vary enormously.

D. Even When Satellite Tiers Are Scrambled, "Basic Only" Customers Frequently Do Not Have Addressable Boxes

There is another design common in urban markets. The tier channels -- and in some cases the basic "broadcast" channels -- will be scrambled as an anti-piracy measure. Theft in urban markets is so rampant that trapping is an ineffective security measure. Scrambling all tier signals, as Greater Media does in Philadelphia, creates an encrypted barrier to theft, so long as the supply of "pirate" chips and "pirate" addressable converters is policed. In such systems, a premium and satellite tier subscriber could be permitted to drop the satellite tier by readdressing the box to deauthorize the satellite tier but not the premium signal. However, a basic only customer would not have an addressable box in place (unless the broadcast channels were also scrambled.) To permit a basic customer to buy premium services without satellite tier, an operator would need to purchase and install a new addressable box at the basic-only set.

II. APPLICATION OF THE SATELLITE TIER BUY THROUGH RULE AND IMPLEMENTATION EXCEPTION

A. The Satellite Tier Buy Through Restriction Does Not Apply to Non-Addressable Headends

We agree with the Commission's interpretation that the satellite "tier buy through" restriction does not apply to a headend which is not addressable. The industry and legislative concerns which shaped the statute focused on the cost of installing addressable headends and the cost of deploying addressable converters. One industry study estimated a cost of addressability at $1.64/mo/subscriber, or more than $5 billion. E.g., TCI Rate Study Adds Fuel to Cable Bill Fire, Multichannel News, August 31, 1992; Communications Daily, August 26, 1992. An opponent of the bill feared that the anti-buy through provision "requires cable operators to install sophisticated addressable converters in all subscriber homes." 138 Cong. Rec. S 14603 (Sep. 22, 1992). In response, sponsors of S.12 pointed to the Conferees' decision to delay those costs for 10 years. A Grassley-Inouye colloquoy is illustrative:

> Sen. Grassley: I am concerned that this provision may require some cable operators to install addressable technology that could increase their costs of providing service.

Sen. Inouye: In response to the concerns about costs expressed by some cable operators, however, the Conferees on S.12 gave cable operators 10 years to comply with this provision ...

138 Cong. Rec. S 14608-09 (Sep. 22, 1992).

The Statute expressly contemplates that compliance will be effected through addressability. § 623(b)(8)(B) ("addressable converter boxes"); § 623(b)(3) (installation of "addressable converter box or other equipment as is required to access programming described in paragraph (8)"); § 623(b)(5)(C) (downgrade by "coded entry on a computer terminal" at addressable headend.) The Statute's reference to "other technological limitations" was intended to provide the FCC ample authority to waive the requirements even for addressable systems. Conference Report 102-862 at 64; 138 Cong. Rec. S 14603 (Sep. 22, 1992). Thus, systems which are not addressable are not required to comply with the "tier buy through" rule during the 10 year implementation exception.

B. The Satellite Tier Buy Through Restriction Does Not Apply to Systems Which Do Not Scramble the Satellite Tier

The Statute is more difficult to apply in "hybrid" systems which, for example, scramble premium services but not the satellite tier, and deploy addressable converters only to premium subcribers. With respect to addressable subscribers, it may not be possible to deliver the basic and premium channels without the satellite tier, because the traps and filters used to block the tier will also block premium channels. The Statute provides no evidence of intent to require such systems to incur the cost of reconfiguring and reprocessing its entire lineup at the headend and then imposing complex and burdensome trapping and filtering solutions: as noted above, it anticipated the installation of addressable converters at subscriber premises so that changes in service could be effected at nominal cost by "coded entry on a computer terminal."

While it is possible at considerable cost and inconvenience to customers to realign all channels to allow basic subscribers to "buy around" the satellite tier to reach pay, it is not required by the statute. Indeed, the Commission should note the high value which most subscribers assign to satellite tier services. For example, approximately 0.6% of Western's subscribers elect not to subscribe to tier services. The Commission should also note the declining popularity of pay.

Again, only 38% of Western's basic households take premium services. We question the wisdom of compelling operators to suffer the substantial costs required to accommodate the relatively few subscribers likely to buy around the satellite tier.

We conclude that systems which do not scramble and address the satellite tier are, essentially, nonaddressable systems as to the satellite tier, and have 10 years to invest in the technology to meet the "buy through" requirement.

C. <u>The Satellite Tier Buy Through Restriction Permits Recovery of Special Converter Charges When Installing Addressable Boxes in Basic-Only Homes</u>

Systems which do scramble the satellite tier but which do not have addressable converters placed in "basic-only" homes face a dilemma. They are technically capable of permitting a premium customer to drop the satellite tier, because the converter is on site. They are not technically capable of permitting a basic-only customer to upgrade to premium (without satellite tier) without dispatching a truck, and installing the new converter at the basic home. The operator has two choices:

The operator could permit current premium customers to drop the satellite tier if a box is in place. But the operator could not permit current basic-only customers to buy premium alone without investing in new addressable converter boxes, which the Congress sought to postpone for 10 years. This, however, creates the anomaly of "old" subscribers buying around the satellite tier while "new" subscribers could not. It also creates an incentive for "new" subscribers to buy premium with satellite tier, get the converter and then drop the tier like an "old" subscriber.

Alternatively, an operator could install a new addressable converter and permit a "basic" only subscriber to skip the satellite tier to buy premium services. However, unless the operator can recover his converter costs from the "new" subscriber, this would impose precisely the cost increases which Congress sought to avoid. These costs are of particular concern because they would be incurred for analog boxes when the industry is on the threshold of digital boxes.

We believe the better alternative is to permit an operator to provide an addressable converter to a new subscriber if that subscriber bears the cost of the converter. That cost would be the difference between an addressable and non-addressable converter (or, in some circumstances, the full cost of an addressable converter where no converter is otherwise required.) Whether the cost would be recovered over time (such as the remaining economic life of an analog converter) or up front is a pricing decision which should be left to an operator's market judgment. The benefit of this approach is:

(1) It avoids discrimination between "old" and "new" subscribers.

(2) It comports with the legislative intent that "the buy through provision ... should not result in an increase in cable rates," 138 Cong. Rec. S. 14603 (Sep. 22, 1992), and the explanation that "Chairman Markey [is] allowing the equipment cost to meet this provision to be passed along to the consumer," 138 Cong. Rec. H 6508 (July 23, 1992).

(3) It gives meaning to the instruction that an operator install an "addressable converter box" if requested by the subscriber to buy premium without tier. [§ 623(b)(3)(A)]

Although it is possible that "old" subscribers would not have been charged a box fee in the past, while "new" subscribers will, this should be an expected result of the changes wrought by the 1992 Act. It is not discrimination, nor a departure from a "uniform rate structure." It is an effort to extend the benefits of addressability to previously non-addressable customers without imposing pressure on rates.

III. APPLICATION OF THE DISCRIMINATION RULE

The corollary non-discrimination rule in 623(b)(8) applies only to systems subject to the tier buy through prohibition. The Commission has questioned how cable operators discount practices may be reconciled with that requirement that an affected cable operator "may not discriminate" between basic-only and other subscribers with regard to rates charged for premium or pay-per-view programming.

A. Installation, Package, and Other Discounts Are Common and Beneficial

It is common for operators to offer discounts to encourage subscriptions to more than basic service. Installation discounts are crucial to increasing subscriber penetration. For example, Greater Media reports that over half of its new customers each year are attracted by installation discounts. Among the most common discounts are:

1. Free or reduced installation if a customer takes basic, satellite tier, and one or more premium services. Product discounts and reduced installation charges are used in most businesses to induce customers to sample services.

2. "Multi-pay" discounts, in which two pays

are available at a lower price than each would cost a la carte. An example is Western's HBO/SHO package priced at $15.00. Multi Pay discounts are especially prevalent to meet competition from pay TV competitors (such as home video).

3. "Packages" in which the a la carte rate for basic, satellite tiers, premiums, remotes, or guides are discounted to encourage subscription to all. A variation, common in the telephone industry, is a percentage discount which increases as the total bottom line charge increases.

All of these pass along to customers some of the economies of delivering multiple services to one residence. It is also good marketing, comparable to package pricing in most other businesses (season tickets, 1 cent sales, magazine promotions and subscriptions, and the telephone discount noted above). See, e.g., Bundling of Cellular Customer Premise Equipment & Cellular Service, 7 F.C.C.Rcd. 4028, 4030-31 (1992).

Such marketing flexibility is important to permit operators to experiment with customer options. For example, in a portion of Western's San Mateo County (CA) system, Western recently offered various discount packages comprising cable service, unlimited additional outlets, all required converters and remotes, and various combinations of premium services to test "whole house" sales and to remove converters from the home. More than half the customers opted for the packages; premium units increased from 1,200 to 3,300; A.O.s more than doubled; households receiving premium service increased from 27% to 42%; basic penetration increased from 74% to 76%; customer satisfaction increased substantially (for example, a 9% increase in "good to excellent" ratings, a 3% decrease in "fair to poor" ratings, and an increase in overall satisfaction from 58% to 74%). The removal of converters was particularly popular. Only the marketing flexibility available from package discounts made possible this "whole house" experiment, and this increase in customer satisfaction.

B. Installation, Package, and Other Discounts Do Not Violate Buy Through Rules

None of these discounts violate the buy through/discrimination restriction. Specifically:

1. Installation discounts make economic sense if an operator can recover some of the cost in tier and premium prices. They make less sense when the basic-only customer takes less product from which an operator may make a return. The basic-only customer is given exactly the opportunities for discounts available to other customers.

2. Multi-pay discounts do not distinguish between basic-only and satellite tier subscribers. Consider the Commission's note 7 example, in which an HBO subscriber is "offered Showtime for a price lower than a subscriber who does not buy HBO." Showtime does not "cost" less to the two-pay customer than to the one pay customer. Showtime is always available at the first pay price to any first pay customer. Only if one subscribes to two pays does the cost for each decline. "Non discrimination" among customers does not mean that each receives the lowest unit rate regardless of what the customer buys.

3. Package discounts do not penalize a basic-only customer. They reward customers who take many products. Thus, a satellite tier customer who also buys HBO at $10 may be rewarded with a free program guide, whereas a basic-only customer who also buys HBO at $10 should not qualify for the same guide. Likewise, a $10 pay service may be packaged with a $10 satellite tier so that a subscriber to the pay/tier package receives a package discount of $2. (This is common in a system where a converter is needed for both satellite tier and pay. A subscriber to both is given a discount because the pay subscription provides the converter). The package rate is not a "rate charged for video programming offered on a per channel or per program basis." The same nondiscriminatory $10 pay rate is being extended to basic customers; but if the basic customer does not take the pay/tier

package, she does not qualify for the package discounts. In other words, both a la carte and satellite tier rates may be discounted through packages without violating the discrimination proscription.

CONCLUSION

For the foregoing reasons, the undersigned suggest that the Commission adopt the following buy through regulations.

76.____(a). A cable operator may not require the subscription to any tier other than the basic service tier as a condition of access to video programming offered on a per channel or per program basis. "Tier" means a group of video programming services which are sold only in combination, other than video programming carried on the basic service tier and video programming offered on a per channel or per program basis.

(b) A cable operator may not discriminate between subscribers to the basic service tier and other subscribers with regard to the rates charged for video programming offered on a per channel or per program basis. A cable operator may extend discounts or other promotional benefits to subscribers of packages of services if subscribers to basic service may qualify for the discount or benefits by purchasing the same package. A cable operator may assess a separate and distinct converter charge (in addition to applicable installation charges) as a condition to installing converters necessary for subscribers to the basic service to access video programming offered on a per channel or per program basis.

(c) The prohibitions in subsections (a) and (b) shall not extend to systems which do not authorize or deauthorize all non-basic services by addressable converter. This exception shall expire October 5, 2002, unless the Commission waives compliance pursuant to subsection (d).

(d) On petition by a cable operator, the Commission may waive the requirements of this Section and/or extend the compliance date if the Commission determines that compliance would require the cable operator to increase its rates or that waiver is otherwise in the public interest.