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FEDERAL COMMUNICATIONS COMMISSION
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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C.

Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	)	MM Docket No. 92-266
Rate Regulation	)	

REPLY COMMENTS OF CONTINENTAL CABLEVISION, INC. ON FURTHER NPRM

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List A B C D E

TABLE OF CONTENTS

I. Low Penetration Systems Cannot Be Read Out of the Definition of "Effective Competition" For Any Purpose 1

II. Penetration of Less than 30% Reflects Lack of the Market Power Which Congress Attributed to Cable 4

A. Low Market Share Is An Accepted Measure of Market Power 4

B. The Telcos' "Study" of Below-30% Markets Is A Self Interested Collection of Unscientific Guesswork 5

III. The Commission Should Act Upon the Facts, Not Political Prejudice 10

A. Exclusion of Below-30% Markets Is Part of Chronic Efforts to Force Fit Facts to Meet Uninformed Regulatory Prejudices 10

B. Exclusion of Below-30% Markets Will Restructure the Entire Cable Industry Based Upon a Snapshot of 27 Small Systems, Without Any Basis in Statistical Reason 11

CONCLUSION 13

SUMMARY

Congress has provided that in regulating basic rates, the Commission "shall take into account ... rates for cable systems ... subject to effective competition." In conducting cases concerning cable programming service rates, it "shall consider" the same rates from the same markets. Nothing in the statute provides the Commission with authority to ignore that unequivocal mandate or to rewrite the definition of effective competition. The ACLU decision forbids the Commission from taking such liberties with the Act. Some commentators suggest that below-30% markets are defined as "effectively competitive" solely to protect small, rural, and new systems from regulation. But Congress knew precisely how to address such systems in its small system, rural telco, and three-year holding provisions, and did not do so in its rate regulation mandate.

Congress included below-30% markets in the definition of effective competition because such markets are free of the market power Congress ascribed to more heavily penetrated cable operators. This is confirmed by the antitrust law reviewed in Continental's earlier comments, and should come as no surprise, since it is a measure of market power followed by the FCC and telephone companies themselves. The telcos' comments should be seen for what they are: gratuitous comments by those whose only interest is to deny cable the revenues needed to upgrade its infrastructure and potentially compete with the telcos' local monopoly. The Hazlett study is a collection of unscientific

anecdotes containing no market research but ample supposition. If he is correct that operators in below-30% markets have market power and are maximizing profits, how is it that Continental's South Central Los Angeles system can achieve neither profits nor market share? Nor is his logic sound in explaining away low penetration. He seeks to dismiss each below-30% market as too old, too non-white, too poor, too rural, too theft-ridden, too small, or too doubtful on the numbers. Continental has high-penetration systems with each of these characteristics. If cable didn't serve such customers, cable would only be a niche service for white suburban yuppies in crime-free communities.

Efforts to exclude the below-30% markets from effective competition are just one more example of a chronic problem in this rulemaking: efforts to force fit facts into regulatory prejudices, without, as CFA puts it, "empirical evidence of any kind." For example, the Commission has already "found" a 10% variance between competitive and noncompetitive rates, even though the Commission's own data shows no statistically significant difference in overbuild prices and overall prices among systems with more than 5,000 subscribers. To meet uninformed regulatory expectations, the Commission has arbitrarily slashed the rates in systems serving 86% of the nation's susbcribers without regard to facts. Removing the below-30% markets will triple the rate cut for the entire cable industry, based solely on rates charged by 27 small systems. That leaves the benchmarks devoid of statistical validity.

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REPLY COMMENTS OF CONTINENTAL CABLEVISION, INC. ON FURTHER NPRM

Continental Cablevision, Inc. hereby replies to the comments suggesting that the Commission revise its definition of "rates for cable systems ... that are subject to effective competition" so as to still further depress benchmark rates below the 10% reduction already prescribed by Commission rules. The suggestion is to exclude systems with fewer subscribers than 30% of the households in the franchise area in order to achieve a 28% rate cut.

I. Low Penetration Systems Cannot Be Read Out of the Definition of "Effective Competition" For Any Purpose

Even proponents of the plan to exclude below-30% markets -- including NATOA, CFA, and the telephone industry -- concede that "effective competition" is a statutorily defined term which cannot, under ACLU,[1/] be massaged away through interpretation.[2/] Their argument is that "effective competition"

1/ ACLU v. FCC, 823 F.2d 1554, 1567 (D.C. Cir. 1987) cert. denied 485 U.S. 959 (1988).

2/ Comments of National Association of Telecommunications Officers and Advisors, et al ("NATOA") at 7; Comments of

[Footnote cont'd.]

has two distinct meanings. They argue that below-30% markets are included in a protection of "small," "rural" and "new" systems from the burdens of regulation. Telcos Comments at 9-10; NATOA at 6-7. But, they say, when it comes to actually regulating rates, the Commission may look at and then disregard below-30% markets, on the theory that by closing its eyes after a glance the Commission will have satisfied its duty to "take into account" markets with effective competition. These statutory revisionists are wrong for five reasons:

1. Congress mandated that the Commission design rate regulations for basic service to protect subscribers from rates that exceed those "that would be charged if such cable systems were subject to effective competition." 47 U.S.C. § 543(b)(1). Further, in setting basic rates, the FCC "shall take into account ... rates for cable systems ... subject to effective competition" as a class. 47 U.S.C. § 543(b)(2)(C)(i). There is no authority to ignore the statutory mandate, to ignore the definition of "effective competition," or to pick and choose among such rates

for cable systems ... subject to effective competition" as a class. 47 U.S.C. § 543(c)(2)(B). There is no authority for the Commission to ignore the mandate and the definition to decide that it will never consider rates in the below-30% markets in the individual cases it is supposed to conduct on CPS tier rates.

3. Congress' inclusion of below-30% markets in the definition of "effective competition" markets cannot be dismissed as an effort limited to protecting small, rural, or new cable systems. Congress knew precisely how to address such systems: small systems are given exemptions from rate regulation and must carry, 47 U.S.C. § 543(i), 534(b)(1)(A); rural areas are opened to telephone competition, 47 U.S.C. § 533(b)(3); new cable systems are regulated by trafficking rules, 47 U.S.C. § 537(a). Accepted rules of statutory construction preclude a finding that Congress intended its below-30% provision to be as narrowly focused as the revisionists pretend.

4. If it is true that one may properly "take into account" and "account for" statutory factors by considering and

5. The 1992 Act is rife with loose language. But one mandatory purpose is clearly to set basic service rates at levels prevailing in markets subject to effective competition. 47 U.S.C. § 543(b)(1). The Commission would contravene that purpose by setting rates lower than rates prevailing in those markets.

II. Penetration of Less Than 30% Reflects Lack of the Market Power Which Congress Attributed to Cable

include below-30% markets in that equation, but it should come as no surprise to them. Market share is routinely used as a measure of competition by telecommunications analysts. See, e.g., P. Huber, The Geodesic Network II, § 2.68, 4.20, 4.44. Telephone companies nationwide have argued in State PSC's and in court that reduced market share represents effective competition and marketplace rates. See, e.g., United States v. Western Electric Co., 767 F.Supp. 308, 312 (D.D.C. 1991) ("The Regional Companies ... contend most notably that they presently lack any market share and therefore could not possibly have any market power.") aff'd, 1993 U.S. App. LEXIS 12584 (D.C. Cir. May 28, 1993). Now, in the FCC, they claim that cable operators continue to exercise market power even when 70+% of the market chooses not to subscribe.

B. The Telcos' "Study" of Below-30% Markets Is A Self Interested Collection of Unscientific Guesswork

The Joint Comments of Bell Atlantic, GTE and NYNEX should be seen for what they are: gratuitous comments by third parties who have no interest in this docket other than to cause serious financial harm to potential competitors. Bell Atlantic, GTE and NYNEX's sole objective is to deprive the cable industry of the revenues it needs to upgrade its infrastructure and potentially compete with the telcos' local monopoly.

To support their new ability to divine market power despite low penetration, the telcos commissioned a "study" by Professor Thomas Hazlett which purports to be "a systematic survey of each system in the Commission's low penetration sample." (p.6). The Hazlett study is nothing more than an unscientific collection of speculative comments by municipal employees intermingled with selected demographic data in an effort to justify the conclusion that "factors other than the presence of competition account for the low penetration" (Hazlett Affidavit, p. 7, para. 15) in such systems. This speculative testimony should be disregarded.

Among the comments he quotes are those of the Mayor of Fayetteville, Texas, who "speculated that the low penetration rate . . . is due in part to the fact that the community is composed of 'mostly older people' who simply 'can't afford it.'"

Similarly, Professor Hazlett relies heavily on anecdotal comments concerning elderly consumers. He quotes the City Administrator for Johnson County, Texas, as saying "that although Johnson County was a 'wealthy community,' many of the residents were 'retired folks' who had concluded that the service 'is not worth the money.'" (Hazlett Affidavit, p. 9, para. 18). Relying again and again on speculative comments such as these,

More important than what Professor Hazlett did is what he did not do. He made no effort to compare the demographic characteristics of the communities in his survey with demographic characteristics of similar communities to see if those characteristics, in fact, accounted for very low penetrations. He did not conduct any market research in any of the subject communities to find out why, in fact, people do or do not subscribe to cable. He made no effort to ascertain the number of broadcast signals or the quality of broadcast reception in any of the communities to ascertain if, in fact, the availability of broadcast signals created effective competition to cable. About the only question Professor Hazlett did seem to ask those he spoke with was whether there was another multi-channel competitor in their town. But that, of course, was self-evident since the FCC had already identified these as systems not having another multichannel video competitor.

Even putting his empirical deficiencies aside, let us analyse Professor Hazlett's logic:

Professor Hazlett contends that below-30% systems have market power and are maximizing profits. Yet Continental's actual experience in below-30% markets is of sustained <u>losses</u>. If Continental had market power in South Central Los Angeles, how is it that it can achieve neither profits nor market share? <u>See</u>, Continental's Comments of June 17, 1993 at 6-9.

Professor Hazlett attributes the low market share of every below-30% system to some seemingly plausible variable: retirement age communities; the wrong demographics; below average income; low density; rural pricing; high crime; "very small" systems; dissatisfaction with service; and -- when all else fails -- a suggestion that the penetration numbers are wrong. But even assuming that there is any empirical merit to his observations, these cannot be determinative variables: Continental has systems with high penetration exhibiting each of these characteristics. For example, Quincy, MA (73% penetration) has 22% senior citizens; Tamarac (57% penetration) has a median age of 63.5; Springfield, MA (64% penetration) has a high theft rate; Lawrence, MA (64.3% penetration) is 42.5% Hispanic and has median household income 25% below the national average. If Professor Hazlett were right in his variables, Continental would be out of business in these communities (or at least have very low cable penetration). Indeed, in Professor Hazlett's world, only white yuppies living in affluent, crime free, suburban communities (with excellent cable service) would subscribe to cable -- not 61% of U.S. households.

It has been said that "he who pays the piper calls the tune." In their zeal to cause financial harm to the cable industry, the telcos appear to have commissioned an entire symphony (with maestro Hazlett conducting).

III. The Commission Should Act Upon the Facts, Not Political Prejudice

A. Exclusion of Below-30% Markets Is Part of Chronic Efforts to Force Fit Facts to Meet Uninformed Regulatory Prejudices

This rulemaking has been plagued by a chronic problem: trying to forcefit the facts into uninformed regulatory presumptions. As CFA admits, Congress adopted the Act without "empirical evidence of any kind," (p.4) yet the Act is predicated on "findings" of excessive rates and market power upon which the telcos rest their case. The FCC has dutifully "found" an average 10% "excess" in rates -- even when there is no statistically significant difference in the rates of 5,000+ subscriber systems whether they are "competitive" or not.[5/] Even the 10% "finding" does not placate the cries for deeper cuts from those who -- without any "empirical study" -- assumed that rate gouging was prevalent. So the cry to exclude below-30% markets is raised, to make the facts fit the prejudices. But it would be irrational and arbitrary for the FCC to yield to those prejudices.

5/ See Economists, Incorporated, The Effect of "Competition" On Rates Differs for Large and Small Cable Systems at 4-7 (1993) (Attached to Petition for Reconsideration filed by the National Cable Television Association, Inc., MM Docket No. 92-266 (June 21, 1993)) ("Economists, Incorporated Study").

B. Exclusion of Below-30% Markets Will Restructure the Entire Cable Industry Based Upon a Snapshot of 27 Small Systems, Without Any Basis in Statistical Reason

The effect of eliminating the 64 systems with less than 30% penetration from the group of systems that face effective competition would be to tie the pricing for 33,000 communities across the U.S. exclusively to the pricing of 46 overbuild systems. Of those 46 overbuilds, 27 are small systems with less than 5,000 subscribers, 19 are systems which serve more than 5,000 subscribers.

Eighty-six percent (86%) of U.S. cable subscribers are served by systems of 5,000 or more subscribers. For systems with more than 5,000 subscribers there is no statistical difference between their rates and the rates of the 19 systems with more than 5,000 subscribers in the FCC's overbuild sample.[6/] In other words, the rates for overbuilds which have attained any significant size mirror the rates of systems which serve 86% of the nation's cable subscribers.

To come up with the alleged 28% rate differential between competitive and non-competitive systems, the Commission would have to rely solely on the 27 remaining below-5,000 subscriber overbuild systems in its sample. Despite the fact

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6/ Economists, Incorporated Study at 4-7.

that these systems have virtually nothing in common with cable systems that serve 86% of the nation's cable TV households, their rates would be used to set benchmarks for an entire industry. As a practical matter, there is no basis in the record to assume that such atypical systems exhibit cost characteristics applicable to the entire industry. As a statistical matter, the sample would be so small as to render the measure useless. Indeed, even the 46 system overbuild sample is statistically meaningless for the purpose of projecting rates for all cable systems, because the margin of error entirely swallows any rate differential. See Affidavit of Economics & Technology, Inc. (Exhibit A).

Efforts to exclude below-30% markets from the "effective competition" benchmark are just more evidence of wrong-headed refusals to face facts. Too many have assumed without "empirical evidence of any kind" (to quote CFA) that competition will reduce all cable rates, irrespective of the underlying capital-intensive costs of delivering cable service. Airlines are competitive but produce high air fares and large losses. Competition in health care increases costs. Automobile sales are competitive but prices still must recover the manufacturers' and dealers' costs. Cable rate wars are short-lived, small system phenomena which disappear with age and system size. The Commission would be far better served by studying the empirical characteristics and actual costs of the

cable industry, rather than trying to force facts into an irrational mold to serve political agendas.

CONCLUSION

For the foregoing reasons, and those contained in Continental's June 17, 1993 Comments, Continental asks that the Commission abandon this FNPRM.

Respectfully submitted,

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STATEMENT OF DAVID J. RODDY, Ph.D.

1. My name is David J. Roddy. I am a Vice President and Senior Economist at Economics and Technology, Inc, One Washington Mall, Boston, Massachusetts 02108. I have over fifteen years of both academic and applied experience with estimation and application of econometric and statistical models, based upon a variety of both basic and advanced methodologies involving data sets of many sizes. A more complete summary of my experience and qualifications may be found in Attachment A to this Statement.

2. Economics and Technology, Inc. (ETI) has been requested by Continental Cablevision to review the regression model and the statistical effects of changing the number of systems by which the Commission derived the benchmark rates in the *Report and Order* (the Order) released May 3, 1993 (*see* Appendix E). The FCC used a set of cable operators in order to define 'effective competition' as required by the 1992 Act. The *Further Notice of Proposed Rulemaking*[1] in this docket suggests narrowing the

[1] FCC 93-177, May 3, 1993, paragraphs 560 - 563.

definition of systems subject to effective competition by excluding cable systems with less than 30% subscriber penetration rates.

3. My analysis used both the rate data initially released by the Commission on February

5. Standard statistical and econometric practice requires a recognition of the random variation which occurs in statistical analysis of different samples of data, including forecast and estimation error. Virtually all, if not all, textbooks in the fields of statistics and econometrics include discussions of the importance of confidence intervals around forecasts and estimates.[2] In addition, Appendix E utilizes a 'stepwise regression' technique to derive the formula.[3] It is well known that this stepwise regression method exhibits some deficiencies relative to traditional regression analysis.[4] This means that the model results are even less reliable than those from a model estimated without using the stepwise regression method.

6. I calculated the 90% confidence interval for the Appendix E regression model excluding from the data set systems with less than 30% market penetration. The average predicted price using this restricted data set is $0.75 per channel. The 90% confidence interval of the model's estimate is a lower bound of $0.53 and the upper bound is $1.08. Thus, for an average system in the data set excluding the under 30% penetration systems, we would conclude that any actual value in this range would represent an 'effectively competitive' system. The wide confidence interval renders the sample effectively useless for predicting a 'competitive' rate or to prescribe rates for those systems not subject to "effective competition, because rates anywhere *within this range of 55-cents per channel are statistically identical to the average rate.*

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[2] See, for example, Greene, William H., *Econometric Analysis*, New York, NY: MacMillan Publishing Company, 1990 (chapters 5 and 6); Theil, Henri, *Principles of Econometrics*, New York, NY: John Wiley & Sons, 1971 (chapters 2 and 3); and Wonnacott, Ronald J. and Wonnacott, Thomas H., *Econometrics, Second Edition*, New York, NY: John Wiley & Sons, 1979 (chapters 2, 3, and 12).

[3] Order, Appendix E, paragraphs 26-27.

[4] *See*, for example Wallace and Asher, "Sequential Methods in Model Construction," 54 *Review of Economics and Statistics*, 172-178 (1972). Indeed, the very software which was used by the FCC, SPSS, contains the following statement: "Stepwise methods build a 'good' equation, but they *compromise* the statistics describing the statistical adequacy. "SPSS On Line Help Manual, Stepwise Regression category" (emphasis added).

I hereby affirm that the matters discussed in the foregoing document are true to the best of my knowledge and belief.

David J. Roddy

Attachment A

Roddy, D. and R. Mayer, "Consumer Interest in New Communications, Information, and Entertainment Services: Statistical Analysis of New Survey Data", *Presented at the Meetings of the Southeastern Association of Regulatory Commissioners*, Orlando, Florida, June 15, 1993.

Economics and Technology, Inc, Theodore Barry and Associates, and Scott, Madden and Associates, *Potential Performance Gains of New York Telephone*, for the New York Public Service Commission, November, 1992. (Statistical and Econometric Chapters)

Analysis of FAS 106 Effects Under Price Caps: A Test Case for LEC Price Cap Regulation by the FCC (with Page Montgomery), submitted July 1, 1992 in FCC Docket 92-101, Treatment of Local Exchange Carrier Tariffs Implementing State of Financial Accounting Standards, by the Ad Hoc Telecommunications Users Committee and the International Communications Association.

Roddy, D., E. Simos, and J. Triantis, "A Two Output, Multi-Input Model of Exogenous and Endogenous Technological Change of the U.S. Economy," *Economic Notes*, Vol. 14, No. 2, 1985.

Roddy, D. and P. Matthews, "A Monthly U. S. Forecasting Model Using the Vector Autoregression Technique," *Data Resources Review of the U.S. Economy*, November, 1981.

Roddy, D., D. O'Reilly, and B. Hui, "Forecasting Economic Activity with a Multiple Time Series Model of the U.S. Economy," *Data Resources Review of the U.S. Economy*, August, 1981.