any one entity from owning cable systems that in the aggregate reach more than 25% of all cable homes passed nationwide, although, we continue to seek comment on subscriber limits in the range of 20%-35%. We believe that a subscriber limit of approximately 25% may be appropriate to prevent the nation's largest MSOs from gaining enhanced leverage from increased horizontal concentration, while ensuring that MSOs continue to benefit from the economies of scale necessary to encourage investment in new programming services and the deployment of advanced cable technologies. We also favor a 25% limit because it will not require divestiture by any cable operator, which we believe would be disruptive to the cable industry. The legislative history of the 1992 Cable Act suggests that the Congress did not intend for our efforts to disrupt existing cable ownership relationships.[137] Nonetheless, before we adopt this specific limit, we want to be certain that we have fully considered all the marketplace implications of such a limit. Therefore, we invite further comment on establishing subscriber limits in a range of 20%-35%.

148. We note that we regard the 10% limit proposed by some commenters to be contrary to the legislative history since it would require divestiture by some cable operators and would sacrifice the efficiencies achieved by horizontal concentration. On the other hand, there is some indication in the record that a higher limit of 30%-35% would be reasonable to allow for future MSO growth without precluding the launch or success of new programming services. In setting a specific percentage limit, we seek to set the limit high enough to preserve the benefits of horizontal concentration, while ensuring that cable operators cannot impede the flow of video programming.

149. We ask commenters favoring limits below 25% to indicate how such limits can be squared with the Senate Report's indication that divestiture of existing systems was not intended. In addition, these commenters are asked to discuss the effect that such divestiture would have on service to subscribers, programming carriage agreements, and on future MSO investment in new programming and technology. Conversely, we ask commenters arguing for a limit above 25% to discuss the effect that such limits will have on the ability of new programming services to obtain MSO carriage and to indicate the competitive rationale for a higher limit, given the lack of competition faced by most cable operators locally and in the program acquisition market. We also ask commenters to address the effect of the prohibitions on anti-competitive practices established under Section 12 and 19 of the 1992 Act on the appropriate level for subscriber limits.

150. We further propose to allow ownership of additional cable systems, beyond the limit ultimately adopted, provided such systems are minority-controlled. The Commission adopted a similar policy in the broadcast context in order to encourage increased minority ownership of media outlets. To date, no commenters have addressed this proposal. We ask commenters to indicate whether allowing such increased ownership is desirable to encourage

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137 See Senate Report at 34 ("the legislation does not imply that any company must be divested").

minority ownership of cable systems as a means of encouraging diversity of programming. We also ask commenters to indicate the appropriate amount of such increased ownership.

151. As we indicated in the Notice, we believe that it is appropriate to measure subscriber limits as a share of homes passed rather than as a share of cable subscribers. Most commenters endorsed this standard, indicating that a measure based solely on the number of cable subscribers is not optimal because it is relatively less stable and would discourage increased subscribership. We prefer a homes passed standard because it more accurately measures a cable operator's potential reach, by encompassing all television households for which a particular cable operator has the ability to provide service. We ask commenters to indicate whether this measure is reasonable and appropriate to our objectives.

152. Also, as referenced in the Notice, we propose to calculate compliance with the national subscriber limits by subtracting the number of homes passed by cable systems in areas where "effective competition" -- as defined under the 1992 Cable Act -- is established.[138] We question, however, whether we should include for this purpose the definition of effective competition that applies to cable systems subscribed to by fewer than 30% of the households in the franchise area. We ask commenters to address whether this definition of effective competition is relevant to the competitive concerns which underlie the establishment of subscriber limits. In addition, some commenters advocate more lenient approaches and, for example, ask us to subtract from the number of homes passed those homes that are also passed by a competing program distributor, regardless of whether "effective competition" is established. We ask commenters to indicate why a more lenient definition of effective competition would be appropriate for purposes of subscriber limits than for purposes of rate regulation since both provisions are concerned with establishing the threshold level of competition at which cable operators will be deterred from engaging in anti-competitive practices. We invite commenters to discuss this issue, as well as our proposal to adopt a homes passed standard, and any other matters relevant to this recommendation.

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138 Under Section 3 of the 1992 Cable Act "effective competition" is established where

> "(A) fewer than 30 percent of the households in the franchise area subscribe to the cable service of a cable system; (B) the franchise area is -- (i) served by at least two unaffiliated multichannel video programming distributors each of which offers comparable video programming to at least 50 percent of the households in the franchise area; and (ii) the number of households subscribing to programming services offered by multichannel video programming distributors other than the largest multichannel video programming distributor exceeds 15% of the households in the franchise area; or (C) a multichannel video programming distributor operated by the franchising authority for that franchise area offers video programming to at least 50 percent of the households in that franchise area." See 47 U.S.C. § 543.

D. Horizontal Attribution Standard.

153. Notice. The Notice questioned whether the broadcast attribution criteria, or some other ownership attribution criteria should be used to implement cable subscriber limits. In particular, we asked if there are other types of ownership interests, such as non-equity interests, that should be cognizable for purposes of determining ownership under our subscriber limits.

154. Comments. With respect to establishing attribution criteria for determining the application of the subscriber limits, cable commenters believe the Commission should focus on the ability of the cable operator to control programming choices. Accordingly, NCTA argues for an attribution standard based on actual stockholder or managerial control of a cable system.[139] In particular, TCI advocates an attribution standard that would (1) exempt ownership interests under 10% ownership; (2) attribute interests of 50% or more; and (3) prorate interests between 10% and 50% based on the number of subscribers served by the system.[140] Cable commenters generally oppose setting the attribution standard at 5% as was done in the program access proceeding.[141] Time Warner, for example, argues that such a strict standard is inappropriate because a 5% interest holder is incapable of influencing a cable system's program choices.[142]

155. On the other hand, MPAA, BellSouth, INTV and GTE advocate a stricter attribution standard than is proposed by the cable industry. Specifically, MPAA favors adoption of the same attribution criteria that is used to determine system ownership in the broadcast context under Section 73.3555 of the Commission's Rules. MPAA believes this criteria has worked well in the broadcast area and contends that the Senate Report instructed the Commission to use the broadcast attribution model.[143] BellSouth urges the Commission to apply the same broadcast attribution model to the telephone, cable and broadcast industries.[144] INTV favors attribution standards similar to those used in the network-cable cross ownership rule. According to INTV,

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[139] NCTA Comments at 21.

[140] TCI Comments at 13-14. TCI would also incorporate a single majority shareholder exception as is used in the broadcast context. Id.

[141] See Program Access Report and Order, 8 FCC Rcd 3359 (1993).

[142] Time Warner Comments at 19-20. Time Warner also contends that Congress did not intend for the Commission to adopt such a strict attribution standard, noting that the Senate Report that preceded the 1992 Cable Act mentioned the broadcast standard under Section 73.3555 as a possible model for developing attribution criteria. Id.

[143] MPAA Comments at 6.

[144] BellSouth Comments at 2.

a 5%-10% attribution standard is warranted because cable operators enjoy a local monopoly.[145] GTE supports establishing attribution standards similar or identical to those applied to the telephone industry in the cable-telco cross ownership rule and as amended in the video dialtone proceeding.[146]

156. Discussion. We propose to adopt attribution criteria similar to the broadcast attribution criteria contained in Section 73.3555 of the Commission's Rules. Generally, under the broadcast attribution criteria, all non-voting stock interests (including most "preferred" stock classes) are generally not attributable. All voting stock interests of 5% or more are generally considered attributable. There are several exceptions to the presumption of attribution created by this 5% benchmark. Most notably there is a single majority shareholder exception, which provides that minority interests will not be attributed where there is a single 51% shareholder. In addition, the interests of "insulated" limited partners are not attributed. We believe that application of these attribution criteria in the context of subscriber limits is appropriate since the same issues regarding influence and control over management and programming decisions are at issue here. However, we request further comment on whether all these criteria are appropriate and applicable in the cable context.[147] We also invite commenters to evaluate the relevance of any of the other provisions or exceptions contained in Section 73.3555 to this proceeding.

157. In favoring the use of Section 73.3555 attribution criteria, we note that the objectives of the broadcast attribution model are consistent with our goals in establishing ownership standards for subscriber limits. In this regard, the broadcast attribution rules focus on ownership thresholds that enable a broadcast licensee to influence or control management or programming decisions. We believe this same approach is relevant to addressing the concerns at issue in this proceeding, which relate to the ability of cable operators to unduly influence the programming marketplace. We also note that the legislative history of the 1992 Cable Act supports the use of the broadcast attribution criteria.[148] Furthermore, the same

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145 INTV Comments at 5-6.

146 GTE contends that the cable industry possesses power in local video distribution rivalling or exceeding the power of local telephone exchange companies in voice transmission. GTE Comments at 3. See 47 C.F.R. § 63.54 (cable-telco cross-ownership restriction). See also Video Dialtone Report and Order, 7 FCC Rcd 5781 (1992). In the video dialtone proceeding, the Commission amended its cable-telco rule to permit ownership interests of up to 5% by telephone companies in video programmers. Id. at 5802.

147 See 47 C.F.R.§ 73.3555 (Notes).

148 See Senate Report at 80. The Senate Report indicates that the Commission should use the attribution criteria set forth in Section 73.3555 (Notes) of our Rules, or such criteria as the Commission deems appropriate in determining ownership under the subscriber limit regulations.

attribution criteria are used in the network-cable cross-ownership rule.[149] We believe that use of this attribution standard in these related contexts supports use of the same standard in the context of cable horizontal ownership limits.

158. Several commenters advocate a stricter approach, such as the video dialtone attribution standard, which attributes 5% voting or non-voting stock interests without exception.[150] While such an approach is consistent with the attribution criteria used in other cable contexts (e.g., program access and cable/MMDS and cable/SMATV cross-ownership), we conclude that such an approach is unwarranted in this context.[151] This strict standard was developed as a modification of the cable/telco cross-ownership restriction in order to allow limited participation by telephone companies in the provision of video programming. These strict attribution standards were designed to ensure competition among rival distribution technologies. In this proceeding, however, our aim is to prevent any one cable operator from impeding the flow of video programming, which we believe warrants less restrictive attribution criteria.

159. In addition, several cable interests advocate that our attribution standard should focus exclusively on control, since in the absence of control, an operator does not have the ability to direct a system's programming choices.[152] Specifically, cable commenters would apply an ownership standard based on stockholder or managerial control of a cable system. Our attribution rules have long recognized that parties that have less than a majority equity interest in a media property can influence management and programming decisions.[153] We see no reason at this time to

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149 See 47 C.F.R. § 76.501.

150 See supra paragraph 155.

151 The Commission adopted a strict attribution standard to implement Section 19 of the 1992 Cable Act. Specifically, a cable operator with 5% or more of the stock of a programmer, whether voting or nonvoting, is deemed to hold an attributable interest in that programmer for purposes of the regulations implementing Section 19. See Program Access Report and Order, 8 FCC Rcd 3359 (1993).

152 See Time Warner Comments at 30-31. See also Discovery Comments at 19-20; NCTA Comments at 20-21; and Liberty Media Comments at 36-37. Time Warner argues "control" normally is achieved by majority stock ownership, but does not necessarily want the Commission to adopt a "bright line" control standard. Rather, it would have the Commission evaluate ownership relationships on a case-by-case basis to determine whether an operator is impeding the flow of programming.

153 See 47 C.F.R. §§ 73.3555 and 76.501. These provisions were last reviewed comprehensively in 1984. See Report and Order in MM Docket No. 83-46, 97 FCC 2d 997 (1984) (Attribution Order), reconsidered 58 RR 2d 604 (1985) (Attribution Reconsideration Order), further reconsidered 1 FCC Rcd

diverge from this longstanding principal. We encourage commenters to discuss these conclusions.

160. Finally, we do not endorse TCI's proposal to that we adopt a prorated attribution standard for all stock interests above 10%. First such an approach assumes that a 10% equity threshold is appropriate. However, this issue is currently being considered by the Commission in a separate rulemaking proceeding.[154] Moreover, such an approach fails to account for de facto control situations, where holders of a minority interest exercise actual control over management and programming decisions. When such de facto control exists, access to all of a system's subscribers is affected, and therefore all subscribers should be attributed.

E. Jurisdiction and Enforcement.

161. Notice. The Notice asked commenters to address how compliance with the subscriber limits should be monitored and enforced. Noting that few cable systems are presently in the range of the proposed subscriber limit of 25%-35%, the Notice suggested that a system of certification may be sufficient to enforce such limits. We indicated that we could require cable operators upon transfer or assignment of a cable system to certify that the transfer or sale would not violate the subscriber limits (i.e., by resulting in ownership of cable systems whose combined subscribership exceeds our limit). We asked commenters to discuss the merits of certification and whether all cable systems or only the largest systems should be subject to such certification requirements. Alternatively, we indicated that we could enforce subscriber limits on a complaint only basis, whereby parties believing that a particular acquisition would violate the subscriber caps, would notify the Commission of the potential violation. Finally, we questioned whether waivers or exceptions to the subscriber limits should be used in some circumstances and whether we should periodically review the ownership limits to ensure that our regulations are responsive to dynamic nature of the cable industry.

162. Comments. Commenters responding to jurisdiction and enforcement concerns agree that the Commission should enforce the subscriber limits on its own initiative. NCTA and Time Warner argue that implementation of a complaint and certification process would be unnecessarily costly and burdensome.[155] They point out that no system is in immediate danger of violating the 25% subscriber limit proposed in the Notice and that the Commission can readily enforce its limits using publicly available data. Time Warner specifically opposes an enforcement process that would direct complaints to the local franchise authorities. Time Warner argues that local franchise authorities do not have the resources or the experience to properly

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802 (1986).

154 Notice of Proposed Rule Making and Notice of Inquiry, 7 FCC Rcd 2654 (1992) ("Capital Formation Proceeding").

155 NCTA Comments at 23-23; Time Warner Comments at 31-33.

assess subscriber limit compliance matters.[156]

163. On the question of whether we should allow for waivers or exceptions in appropriate circumstances, Time Warner and NCTA suggest that such waivers or exceptions should be obtainable for expansion of service into previously unserved rural areas and for de minimis violations (i.e., when commercial circumstances temporarily place an operator over the limits).[157] In addition, MPAA, Time Warner and NCTA favor the Commission's proposal in the Notice for periodic review of the subscriber limits every five years.[158]

164. Discussion. We propose that the FCC should enforce the suggested subscriber limit. We believe that in enforcing the subscriber limits it may be unnecessary to institute a formal certification process, whereby all cable operators must verify upon transfer or assignment of a cable system that they are in compliance with our subscriber limits. Commenters have suggested and we agree that such a process would be unnecessary and unduly burdensome since only a few MSOs are close to the proposed 25% threshold. However, we request additional comment on whether such certification should be required for cable operators currently reaching 20% or more of homes passed. Alternatively, it may be possible for us to adequately monitor and enforce subscriber limits through the use of readily obtainable public information regarding cable system ownership. Commenters favoring such an approach should indicate whether the necessary information regarding cable system ownership and the share of homes passed by the largest MSOs is publically available and the appropriate source that should be used to obtain such information on a regular basis. In addition, we believe that the Commission, and not the local franchise authorities, are the appropriate entity to consider any complaints asserting that a particular MSO is in violation of the subscriber limits. We seek comment on these proposals.

165. Cable commenters have also requested that we waive or exempt MSOs from the subscriber limits in instances of de minimis violations (such as when an acquisition temporarily places a cable operator over the permissible number of subscribers) or when an MSO is seeking to expand service into an otherwise unserved rural area. We agree that waivers may be appropriate in these situations and propose to consider such waiver requests on a case-by-case basis. We invite commenters to discuss these conclusions and indicate whether waivers may be appropriate in other circumstances.

166. Finally, in view of the fact that the cable market is a dynamic and changing industry, we believe that periodic review of the ownership limits is necessary. As we proposed in the Notice, we plan to review the subscriber limits every five years to determine whether such limits are reasonable under the prevailing market conditions. Commenters responding to

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156 Time Warner Comments at 31-33.

157 Time Warner Comments at 34; NCTA Comments at 23 n.50.

158 MPAA Comments at 6-7; Time Warner Comments at 35; NCTA Comments at 23.

this issue generally favored a five year review. We invite further comment on this proposal and ask commenters to indicate whether review every five years will be adequate to ensure that our regulations are responsive to the dynamic nature of the cable industry.

V. CHANNEL OCCUPANCY LIMITS

A. Background

167. Section 11(c)(2)(B) of the 1992 Cable Act requires the Commission to establish reasonable limits on the number of cable channels that can be occupied by a video programmer in which a cable operator has an ownership interest ("channel occupancy limits").[159] In adopting this provision, Congress found that the cable industry has become increasingly vertically integrated and that as a result cable operators have the ability and the incentive to favor their affiliated programmers. Vertical integration in this context refers to common ownership of both cable systems and program networks, channels, services or production companies. Such integration, Congress determined, could make it difficult for non-cable affiliated or competing programmers to secure carriage on vertically integrated cable systems.[160] Similarly, Congress found that vertically integrated program suppliers also have the incentive and the ability to favor their affiliated cable operators over unaffiliated operators and program distributors using other technologies.[161]

168. By requiring the adoption of channel occupancy limits, Congress sought to reduce the incentive and ability of cable operators and video programmers to engage in anti-competitive practices. In addition, the Senate Report expressed concern that vertical integration limits diversity of cable programming and reduces the number of voices available to the public. In this respect, the channel occupancy limits were also intended to increase the diversity of sources of cable programming.[162]

169. <u>Proposal</u>. After considering the record submitted in response to the <u>Notice</u>, we continue to have questions and concerns regarding the appropriate level at which to establish channel occupancy limits and the proper application of such limits to specific types of programming. While our review of the record and our analysis of the market structure has enabled us to reach certain tentative conclusions, we seek additional information and comment regarding these conclusions and additional information regarding how such proposals will affect continued MSO

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159 47 U.S.C. § 533 (f)(1)(B).

160 Cable Act of 1992, Section 2 (a)(5).

161 <u>Id</u>.

162 Senate Report at 80. The one-to-a-market rule is contained in Section 73.3555 of the Commission's Rules.

investment in new programming services.

170. Briefly, we propose to adopt a 40% limit on the number of channels that can be occupied on a cable system by programming in which the particular cable operator has an attributable interest. Vertical ownership attribution for this purpose would be defined by reference to the broadcast attribution criteria. In addition, we propose to allow carriage of additional vertically integrated video programmers provided such video programmers are minority-controlled or are targeted to a minority audience. We plan to count all activated channels in calculating system capacity and all channels occupied by affiliated programming services would be counted towards the 40% limit. However, we propose to exempt local and regional programming networks from such limits.

171. We further propose to grandfather carriage of all vertically integrated programming services that existed as of the effective date of the 1992 Cable Act, which exceed the channel occupancy limits we ultimately adopt. We also propose to eliminate channel occupancy limits in any community where effective competition is established. In addition, we plan to adopt a maximum channel capacity beyond which the channel occupancy limits will no longer apply.

B. Application of Channel Occupancy Limits.

172. Notice. In the Notice we indicated that the statutory language and legislative history were unclear regarding how Congress intended such channel occupancy limits to be applied. We asked commenters to indicate whether Congress intended such limits to apply only to video programmers affiliated with the operator of the particular cable system in question or whether such limits were intended to apply to carriage of all cable-affiliated video programming on all cable systems. We noted that it was similarly unclear if the latter interpretation were used, whether the channel occupancy limits should be applied cumulatively to all vertically integrated programming or whether such limits should be applied individually to programmers affiliated with each MSO.

173. We indicated that given the uncertainty surrounding the application of the channel occupancy limits, we believed that the more reasonable approach was to apply such limits only to video programmers affiliated with the particular cable operator. We noted that such an interpretation would be consistent with Congress' objectives of increasing diversity and expanding the number of voices available to consumers. Moreover, such an interpretation would address Congress' goal of reducing the ability and the incentive of cable operators to favor their own affiliated video programmers. Commenters were asked to indicate whether this proposal was appropriate.

174. Comments. Cable commenters addressing this issue argue that channel occupancy limits should be applied, and the statutory language requires that they be applied, only to programming in which the particular

cable operator has an ownership interest.[163] These commenters assert that the statutory language and the purpose of the legislation make clear that Congress intended for such limits to apply only to programming services affiliated with the particular cable operator.[164] According to these commenters, cable operators have no incentive to favor a vertically integrated programmer in which they have no ownership interest and have no ability to influence the programming content of such services. Moreover, cable commenters add that application of channel occupancy limits to programming services affiliated with other MSOs would stifle investment in new programming services since the fact of such MSO investment would restrict the programmer's distribution opportunities on all cable systems. Time Warner adds that such an approach may actually lead to favoritism of a cable operator's own services because an operator would lose distribution opportunities for its own services to the extent it carried the services of its competitors.[165]

175. Several commenters argue that the establishment of channel occupancy limits raises serious First Amendment concerns that will be exacerbated by an unnecessarily broad application of such limits to carriage of all affiliated programming services on all cable systems.[166] Turner in particular notes that such regulations directly burden the ability of vertically integrated cable operators and programming networks to speak in violation of their First Amendment rights.[167] By favoring one class of speakers (unaffiliated programmers) over another class of speakers (affiliated programmers), Turner asserts that the channel occupancy limits unconstitutionally target the exercise of protected speech by a limited

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163 NCTA at Comments 31-32; Turner Comments at 15; Cablevision Systems Comments at 10; TCI Comments at 35-36; Time Warner Comments at 45-48; IFE Comments at 7-9; Liberty Media Comments at 23-25; E! Entertainment Comments at 7; Discovery Comments at 16; and Viacom Comments at 6-9; CIC/CC Comments at 35-37.

164 Commenters cite to language in the Conference Report stating that the Commission shall adopt reasonable limits on the "number of channels that can be occupied by a programmer that is owned by a cable operator or in which <u>the</u> cable operator has an attributable interest". Conference Report at 81 (emphasis added).

165 Time Warner Comments at 46.

166 Time Warner Comments at 2; Turner Comments at 20-22; Viacom Comments at 2-3; NCTA Comments at 24; TCI Comments at 29; CIC/CC Comments at 35; Cablevision Systems Comments at 9-10; Liberty Media Comments at 12, n.5.

167 Turner argues that channel occupancy limits should apply only to programing affiliated with a particular cable operator, and in addition, such limits should apply separately to programming services supplied by each video programmer. Turner Comments at 14-16.

class of speakers.[168] Turner also contends that such limits unconstitutionally intrude on cable operator's editorial discretion, by limiting their ability to offer vertically integrated programming services.[169]

176. While TCI agrees that the limits on vertical integration should only apply in cases where a cable programmer and a cable operator are affiliated, TCI proposes that rather than counting channels, the FCC should implement a system based on bandwith. According to TCI, such an approach would be more precise and adaptable in the forthcoming era of digital compression. Under TCI's recommended approach, channel occupancy limits would be calculated by counting each 6 MHz segment as a single unit and applying limits on the number of units that could be occupied by vertically integrated programming. TCI submits that such an approach will encourage cable operators to continue to invest in the development of new technologies and innovative program services.

177. IFE on the other hand, proposes that such limits should apply only when there is a specific complaint of discriminatory practices.[170] Thus, IFE asserts that the Commission should not impose any channel occupancy limits on those operators who do not discriminate against unaffiliated program services. According to IFE, cable operators should not be prohibited from carrying a programming network in which it has invested, if no unaffiliated or competing video programmer has complained that it has

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168 Turner Comments at 20.

169 In our view, the First Amendment arguments advanced by commenters with respect to the channel occupancy limits are without merit. As an initial matter, we observe that cable television's First Amendment status remains unresolved. While cable systems are clearly entitled to First Amendment protection, the Supreme Court has not yet determined whether that protection is the same as that afforded to newspapers, or whether cable systems, like broadcasters, have in some circumstances more restricted First Amendment rights. Whatever conclusion the courts ultimately reach concerning cable television's First Amendment status, economic regulations designed to promote competition and a diversity of voices in the provision of communications services have been upheld against First Amendment challenges. <u>Associated Press v. United States</u>, 326 U.S. 1 (1945). The channel occupancy limits are content neutral and are designed to ensure that cable subscribers receive a diversity of voices, not just programming in which the particular cable operator has an ownership interest. Channel occupancy limits are also intended to ensure that unaffiliated programmers are able to obtain access to vertically integrated cable systems. The Court has upheld against First Amendment challenges government regulations intended to promote competition and a diversity of voices, even if some incidental loss of editorial discretion results. <u>FCC v. National Citizens Committee for Broadcasting</u>, 426 U.S. 775 (1978); <u>U.S. v. Storer Broadcasting</u>, 351 U.S. 192 (1955); <u>Associated Press</u>, 326 U.S. at 19-20.

170 IFE Comments at 6.

been denied access.

178. Discussion. In the Notice we observed that the language contained in Section 11(c)(2)(B) of the 1992 Cable Act was unclear regarding whether the channel occupancy limits were meant to apply only to carriage of video programmers affiliated with the particular cable operator or to carriage of any vertically integrated cable programmer on any cable system. Specifically, Section 11(c)(2)(B) requires the Commission to "establish reasonable limits on the number of channels on a cable system that can be occupied by a video programmer in which a cable operator has an attributable interest."[171] In contrast, the Conference Report, specifies that such limits shall apply to "the number of channels that can be occupied by a programmer that is owned by a cable operator or in which the operator has an attributable interest."[172]

179. In addition, if the statute is read to require limits on the number of channels that can be occupied by any vertically integrated cable programmer, it is unclear whether Congress intended for the Commission to adopt such limits cumulatively (so that, for example, no more than 10 channels could be occupied by all vertically integrated cable programmers) or whether such limits were meant to apply individually to programming services affiliated with each MSO (so that the programming of each MSO could occupy up to 10 channels). The statutory language requiring limits on the number of channels that can be occupied by a video programmer in which a cable operator has an attributable interest could be read to support either interpretation. The Conference Report is similarly unclear on this point. The Senate Report, however, suggests that such limits should apply individually to programming affiliated with each MSO.[173]

180. Given the uncertainty surrounding the application of such limits, we propose that the more reasoned approach is to apply such limits only to video programmers that are vertically integrated with the particular cable operator. We believe that this approach is the most logical interpretation, given Congress' stated objective of encouraging a diversity of voices and preventing unaffiliated programmers from being denied carriage on vertically integrated cable systems.

181. We agree with the majority of commenters who argue that cable

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171 47 U.S.C. § 533(f)(1)(B) (emphasis added).

172 Conference Report at 81 (emphasis added).

173 "On a system with 54 channels . . . the limit would be eight channels that could be occupied by programming owned by an MSO or in which the MSO has an attributable interest. The programming of each other MSO could also occupy eight channels." Senate Report at 80 (emphasis added). Although this example contains contradictory language, it seems to suggest that the limits should apply to each MSO's programming services individually, regardless of whether a particular cable operator and programming service are affiliated.

operators have no incentive to favor programming services that are affiliated with a rival MSO. Moreover, there is no opportunity for a vertically integrated cable operator to control the content or distribution of a programming service in which it has no ownership interest. We also agree with commenters who note that application of the channel occupancy limits to all vertically integrated programmers, regardless of whether they are affiliated with the particular cable operator, would severely inhibit MSO investment in programming services, since the mere fact of such MSO investment would restrict carriage of the programming service on all cable systems.

182. While the Commission in other contexts has recognized some patterns of discrimination by vertically integrated MSO's against unaffiliated and competing cable programmers in terms of requiring a financial interest as a condition of carriage, these concerns are addressed by Section 12 of the 1992 Act.[174] We note that the record in this proceeding, as well as other empirical sources, demonstrate a lack of evidence that might indicate a pattern of vertically integrated MSO's denying system access to unaffiliated or competing cable programmers.[175] In the absence of significant empirical evidence regarding existing discriminatory practices, we see no useful purpose in limiting the ability of cable operators to carry programming in which they have no ownership interest. Such a restriction would be unduly burdensome on MSO investment in cable programming and would be contrary to the purpose of the statute.

183. Only TCI and IFE propose alternative approaches. We seek comment on TCI's suggestion that we implement channel occupancy limits by measuring bandwith rather than traditional channels. According to TCI, such an approach would be more precise and adaptable in the forthcoming era of digital compression. We ask commenters to discuss whether TCI's recommended approach would be preferable to a channel based restriction and whether such an approach would be consistent with Congress' direction that we establish limits on "the number of channels" that can be occupied by vertically integrated programming. We also request that commenters indicate whether a bandwith measure would be more adaptive to cable systems employing digital signal compression and other advanced delivery systems. We seek to adopt regulations that will encourage cable operators to continue to invest

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174 See Program Access Notice of Proposed Rulemaking, 8 FCC Rcd 194, 195 (1992); Program Access Report and Order, 8 FCC Rcd at 3366, n.8.

175 See Study by Robert Crandall "Vertical Integration and Cable Operator Carriage Decisions", attached to Liberty Media Reply Comments, Exhibit A; 1990 Cable Report, 5 FCC Rcd 4962, Appendix G, Table VII, at 5113; Study by Benjamin Klein "The Competitive Consequences of Vertical Integration in the Cable Industry", attached to NCTA Comments, Appendix A; Report by National Telecommunication and Information Administration, "Video Program Distribution and Cable Television: Current Policy Issues and Recommendations" (June 1988), submitted in connection with 1990 Cable Report.

in the development of new technologies and innovative program services and invite commenters to indicate whether there are alternative approaches that might further these objectives. We specifically ask commenters to indicate how the restrictions we adopt can be adapted to video on demand systems. For example, we seek comment on how such limits should be applied in the context of switched digital video systems, which may employ a single channel through which subscribers can access any program on demand. Moreover, we ask commenters to indicate what, if any, provisions should be made in our regulations for the use of cable capacity to provide information and communications services as opposed to video programming services.

184. With respect to IFE's suggestion that we should not impose any channel occupancy limits on cable operators unless an unaffiliated or competing video programmer complains that it has been denied access, we do not believe that such an approach would be consistent with the plain meaning of the statute. Congress did not intend Section 11 to function as a behavioral restraint on anti-competitive conduct; Section 12 and 19 of the 1992 Cable Act, regarding carriage agreements and program access, respectively, were designed for that purpose. Section 11 was intended to impose a structural safeguard to deter anti-competitive practices by vertically integrated cable operators and programming services. For this reason we decline to follow IFE's suggested approach. However, we ask commenters to indicate whether an exception should be made allowing systems to carry additional affiliated programming where no unaffiliated or competing programmer seeks carriage and channel capacity would otherwise go unused.

C. Calculation of Channel Capacity.

185. Notice. In the Notice we sought comment on the appropriate procedures to be used in calculating a system's channel capacity. We observed that the 1992 Cable Act and its legislative history were unclear on this issue. We noted that the Senate Report suggested that the Commission may establish such limits based on the number of activated channels, less the number of over-the-air broadcast public, educational, governmental and leased access channels carried.[176] Parties were asked to comment on whether these procedures for calculating channel occupancy limits were appropriate and reasonably serve the objectives of the legislation.

186. Comments. Most commenters addressing this issue[177] argue that the Commission should take into account all activated channels, including all broadcast, PEG and leased access channels, in calculating system capacity. These commenters note that such channels provide unaffiliated and

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176 Senate Report at 80.

177 NCTA Comments at 29-31; Turner Comments at 17; Viacom Comments at 14; Time Warner Comments at 41-42; Discovery Comments at 16; CIC/CC Comments at 39-40; Liberty Media Comments at 24-25; MPAA Comments at 8.

diverse programming that is competitive with affiliated programming. According to cable commenters, subtracting broadcast, PEG, and leased access channels from the channel capacity calculation is unwarranted as a policy matter and would exacerbate the First Amendment problem inherent is such limits. Moreover, cable commenters argue that such a reduction of the channel base would further discourage cable operators from investing in new programming services, contrary to Congress' stated objective of increasing diversity.

187. Time Warner notes that the hypothetical channel calculation set forth in the Senate Report (subtracting broadcast, leased access and PEG channels from the channel base) is misguided and will discourage investment in new programming services. According to Time Warner, such an approach would reduce the number of channels available to cable operators for vertically integrated program services, forcing cable operators to choose established popular programming services over newer untested services. Time Warner also observes that such an approach would penalize cable operators who carry the most diverse array of broadcast and PEG channels by providing them with fewer channels for vertically integrated programming services.

188. In contrast, INTV and NATOA contend that the FCC should subtract the broadcast must carry, PEG and leased access channels in calculating channel capacity.[178] Neither INTV or NATOA offers any explanation in support of this view.

189. Discussion. The statutory language does not indicate how a cable system's channel capacity should be determined for purposes of applying channel occupancy limits. However, the Senate Report provides a hypothetical calculation in which the cable system's broadcast, PEG and leased access channels are subtracted from the overall system capacity before the channel occupancy limit is applied.[179] Nevertheless, we agree with commenters who argue that all activated channels should be included in the calculation of a system's channel capacity. As we indicated in the Notice, carriage of broadcast, PEG and leased access channels promotes diversity and provides alternative sources of unaffiliated programming to cable subscribers. Accordingly, we believe that these channels should not be subtracted from the base of channels available to cable operators to provide vertically integrated programming.

190. In our view, all activated channels (including those used for non-video services) should be taken into account in calculating system capacity for purposes of applying channel occupancy limits. We note that cable operators are obligated by the 1992 Cable Act to carry local broadcast and noncommercial educational channels, and are required to reserve channel capacity for lease to unaffiliated programmers. Consequently, we conclude that it would be unreasonable to use such channels to reduce the base of channels available for carriage of vertically integrated programing. Such

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178 INTV Comments at 11; NATOA Comments at 21.

179 Senate Report at 80.

an approach would penalize cable operators who carry the broadest array of broadcast channels by decreasing the number of channels available for carriage of vertically integrated programming. In addition, we note that there is precedent for this approach in the must carry and leased access provisions of the Communications Act, which take into account all activated channels in determining a cable operator's carriage obligations.[180] We ask commenters to indicate whether this approach is appropriate and consistent with the objectives of the channel occupancy limits.

D. <u>Vertical Ownership Attribution Standard</u>.

191. <u>Notice</u>. The <u>Notice</u> asked commenters to indicate whether the attribution criteria contained in Section 73.3555 of our Rules would be an appropriate standard for determining vertical integration in the context of channel occupancy limits, or whether a higher attribution standard would be appropriate to encourage continued MSO investment in cable programming. Commenters were asked to address how application of these attribution rules would affect investment by cable operators in new cable programming services.

192. <u>Comments</u>. Commenters addressing this issue propose a variety of vertical integration standards. NCTA and most cable commenters favor an ownership criteria based on control, which they define as either majority voting control or the ability to elect a majority of the board of directors.[181] Discovery argues that if integration is defined as less than control, the regulations should include a behavioral exception which, if satisfied, would exempt a affiliated programming service from attribution.[182] Most cable commenters submit that if an attribution standard below 50% is adopted, it is essential that the Commission retain the single majority shareholder exception provided under the broadcast attribution rules.

193. Cablevision Industries and Comcast Corporation ("CIC/CC") oppose use of the 5% broadcast attribution standard. These parties assert that while a 5% attribution threshold may be appropriate for determining "editorial diversity" in a market with relatively few broadcast outlets, such a standard is inappropriate for purposes of cable channel occupancy limits. CIC/CC assert that because MSO investment in new programming services has been so vital to the development of new programming, a higher attribution threshold is warranted. Consequently, CIC/CC propose an

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180 47 U.S.C. §§ 532, 534.

181 NCTA Comments at 28-29; Time Warner Comments at 37-39; Discovery Comments at 19; CIC/CC Comments at 38; Liberty Media Comments at 12-18; IFE Comments at 10.

182 Discovery Comments at 19-20.

integration threshold of 25%.[183]

194. MPAA proposes an attribution threshold of 15% to implement the channel occupancy limits. MPAA notes that this standard differs from the attribution criteria they recommend in connection with subscriber limits. However, they believe that such a distinction is warranted by marketplace circumstances. In this regard, MPAA observes that it is common for a large number of cable operators to each take a minority position in a programmer, thus spreading control more widely among operators. According to MPAA, such participation by a number of different MSOs warrants a higher attribution level than is applied in cable system ownership, where one MSO generally controls management and operations decisions, including program selection.[184]

195. TCI suggests a vertical integration criteria, pursuant to which ownership interests below 10% would not be attributable; ownership interests above 50% would be fully attributable; and ownership interests between 10% and 50% would be attributable on a prorated basis. TCI contends that this proposal embodies a clear, workable criteria that is superior to proposals favoring _ad hoc_ disputes over the presence or absence of "control."[185]

196. BellSouth and Turner advocate use of the Section 73.3555 broadcast attribution standards. BellSouth argues that the Commission should establish a uniform attribution criteria in this dynamic period of convergence of communications technologies. Turner similarly maintains that the Commission should not apply a more restrictive attribution standard than currently applies to broadcasters.[186] INTV on the other hand, advocates use of the very strict attribution criteria used in the cable/telco cross-ownership restriction.[187] INTV asserts that such a strict attribution standard is warranted because cable operators occupy a monopoly gatekeeper position in local communities.

197. _Discussion_. The plain language of Section 11(c)(2) of the 1992 Cable Act does not indicate the appropriate criteria for determining vertical ownership attribution. The Senate Report, however, suggests that in determining what is an attributable interest, the Committee intended that the Commission use the attribution rules set forth in Section 73.3555 (Notes) of the Commission's Rules or such other criteria as the Commission deems appropriate.[188] We propose to apply the broadcast attribution

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183 CIC/CC Comments at 36-38.

184 MPAA Comments at 7.

185 TCI Comments at 9-12.

186 Turner Comments at 19.

187 47 C.F.R. § 63.54.

188 Senate Report at 80.

criteria for purposes of applying the channel occupancy limits.

198. Commenters propose a variety of attribution criteria, ranging from actual voting control to attribution of all interests greater than 1%. While commenters cite a variety of rationales to justify the varying attribution criteria proposed, the Commission believes that the attribution criteria contained in Section 73.3555 (Notes) of our Rules are appropriate for this purpose. As an initial matter, we note that the Commission does not currently have any directly analogous regulations, which measure vertical integration. Although the Commission recently adopted a strict vertical integration criteria in connection with the program access provisions contained in Section 19 of the 1992 Cable Act,[189] these provisions were intended to impose more narrowly tailored behavioral restraints, prohibiting anti-competitive conduct by vertically integrated cable operators and programmers.[190] These behavioral restrictions warranted application of a strict integration standard that would subject all vertically integrated cable operators and programmers to such behavioral restrictions. The channel occupancy limits, however, impose broader structural constraints, which affect the ability of all cable operators to carry programming in which they have a cognizable interest. Consequently, we believe that a more flexible attribution standard is appropriate to encourage continued investment in the development of new programming services.

199. We similarly reject the more restrictive cable/telco attribution criteria as inappropriate in the context of channel occupancy limits. We believe that such a strict attribution criteria would be contrary to the public interest objectives Congress' instructed the Commission to consider under Section 11. Specifically, Congress directed the Commission to prescribe regulations that account for the efficiencies and other benefits that might be gained through increased ownership.[191] Congress also directed the Commission not to impose "limitations which would impair the development of diverse and high quality video programming."[192] We believe that

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189 First Report and Order, in MM Docket No. 92-265, 8 FCC Rcd 3359 (1993).

190 In the Program Access Proceeding we adopted a vertical integration standard based on the criteria adopted in the Commission's Video Dialtone Rules. 47 C.F.R. § 63.54. These criteria attribute all equity interests of 5% or more, and unlike the broadcast attribution rules they do not contain any exceptions for nonvoting stock, insulated limited partnership interests, or single majority shareholders. The Commission also utilized these attribution criteria to define affiliated programmers in the context of determining pass-through of programming costs for purposes of cable rate regulation. See Report and Order, in MM Docket No. 92-265 (released May 3, 1993) ("Cable Rate Proceeding").

191 47 U.S.C. § 533 (f)(2)(D).

192 47 U.S.C. § 533 (f)(2)(G).

application of either the cable/telco or video dialtone attribution criteria would be contrary to these objectives.

200. In addition, we decline to propose an attribution criteria based on control as is proposed by numerous commenters.[193] The Commission has long rejected a control-based attribution standard, because we recognized that owners of minority interests may exercise substantial influence or control over management and programming decisions of broadcast licensees.[194] Moreover, we believe that interests well below 50% are sufficient to provide cable operators with the incentive to favor an affiliated programming service over a competing programming service with which such cable operator has no affiliation. In addition, the fact that cable operators generally do not face competition from other multichannel video distributors in their franchise area suggests that a stricter integration standard is appropriate to prevent exclusion of unaffiliated cable programming services.

201. In the context of establishing limits on vertical integration in the cable industry we are concerned with identifying interests in cable programming services, which are sufficient to afford influence or control over programming decisions. We also seek to identify interests that might potentially provide cable operators with an incentive to favor an affiliated programming service over an unaffiliated or competing programming service. However, we must balance these concerns with the objective of preserving the benefits and efficiencies of vertical integration and encouraging continued MSO investment in new cable programming services. For this reason we believe that our broadcast attribution criteria are appropriate. The Section 73.3555 attribution criteria were designed to identify all interests that could potentially afford influence or control over management or programming decisions, while providing exceptions which exempt interests above 5% from attribution if there is no realistic possibility of such interests imparting control. Thus, we tentatively conclude that the broadcast attribution criteria are strict enough to identify all interests that afford the potential to exert influence or control over management or programming decisions, yet flexible enough to permit continued MSO investment in new programming services.[195] In this

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193 We similarly reject TCI's proposal to attribute all interests between 10% and 50% on a prorated basis, exempting interests under 10% and fully attributing interests over 50%, for the reasons stated supra at paragraph 176.

194 See Attribution Order in MM Docket No. 83-46, 97 FCC 2d 997 (1984), Attribution Reconsideration Order, 58 RR 2d 604 (1985), further reconsidered 1 FCC Rcd 802 (1986).

195 Significantly, Turner advocates use of the broadcast attribution criteria in this context, which it does not regard as overly restrictive. Turner Comments at 19. Since Turner's programming services have been among the principal beneficiaries of MSO investment, we regard their support of the broadcast attribution criteria as particularly relevant.

regard we believe that the broadcast attribution criteria strike the proper balance between Congress' competing objectives.[196]

202. Because we recognize that there are substantial benefits and efficiencies which derive from vertical integration and because we seek to encourage continued MSO investment in new programming services, we ask commenters to indicate whether there are any modifications or additional exceptions that should made to our attribution criteria to better adapt them for this purpose.[197] For example, we ask commenters to indicate whether a higher equity threshold should be adopted where more than one MSO holds a minority interest in a programming service. Alternatively, we ask whether it would be appropriate to increase the equity threshold or exempt from attribution investments in new programming services.[198] We also question whether there are any insulation criteria, similar to the insulation criteria imposed with respect to limited partnership interests, that would be appropriate with respect to voting stock interests greater than 5%.[199]

E. Percentage Limitation.

203. Notice. In the Notice we sought comment on the appropriate level at which to establish channel occupancy limits. We asked commenters to indicate what criteria should be used to establish such limits. In addressing this issue, commenters were asked to consider the vertical

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196 We recognize that numerous commenters oppose application of the broadcast attribution standards in the context of defining vertical integration for purposes of channel occupancy limits. These commenters generally argue that such criteria are inadequate to define interests which afford cable operators the ability or incentive to control programming decisions or to restrict the availability of a programming service to competing video distributors. These commenters also point out that MSO investment has been essential to the creation of the most innovative and popular cable programming (e.g., CNN, BET, Discovery, C-SPAN, The Learning Channel etc.). Finally, these commenters indicate that because it is common for several MSOs to acquire minority interests in a new programming service in order to spread the risk associated with launching such services, a higher attribution criteria is warranted.

197 For this reason we also reject INTV's proposal to adopt attribution criteria based on the cable/telco cross-ownership restriction, which generally attribute all interests greater than 1% and bar all financial and business relationships. 47 C.F.R. § 63.54.

198 This proposal is similar to proposals made by Discovery and Viacom that we exempt from the channel occupancy limits new programming services for a period of five years. Viacom Comments at 16; Discovery Comments at 18.

199 47 C.F.R. § 73.3555 (Notes).

relationships and ownership patterns reported in Appendix G to the 1990 Cable Report. Commenters were also directed to consider the behavioral restrictions included in Sections 12 and 19 of the 1992 Cable Act, as well as the must-carry[200] and leased access requirements[201] applicable to cable systems. We noted that our intention was to establish a channel occupancy limit that would maximize the number of voices available to cable viewers without impairing the ability or incentive of cable operators to invest in new and existing programming services.

204. Comments. NCTA and most cable commenters indicate that the appropriate level at which to establish channel occupancy limits depends on the Commission's resolution of such issues as the attribution criteria and the types of programming services that will be subject to such limits.[202] These commenters indicate only that the 20% limitation referenced in the Notice is far too low to encourage continued MSO investment in new cable programming services. In addition, most cable commenters argue that the channel occupancy caps must be set high enough to preserve the benefits of vertical integration. In this regard, Discovery and Viacom suggest that a channel occupancy limit of 50% would be reasonable. Cable commenters emphasize that if the FCC applies a strict attribution standard (e.g., 5%), it must establish channel occupancy limits high enough to avoid impeding program investment and distribution.

205. In support of high channel occupancy limits, cable commenters argue that cable investment has added to the diversity of national programming services and made many of the most popular programming services possible. Moreover, cable commenters argue that unaffiliated programmers have successfully obtained carriage on vertically integrated cable systems. Accordingly, cable commenters argue that restrictive channel occupancy limits are unnecessary and would be contrary to the public interest.

206. MPAA on the other hand, favors a 20% limit, stating that such a limit would reduce the risk of MSOs favoring affiliated programmers without inhibiting investment. Moreover, MPAA asserts that their proposed attribution threshold of 15% will provide cable operators with enough flexibility and incentive to expand system capacity in order to raise the number of affiliated services they can carry. INTV also advocates a 20% limit, but suggests that under no circumstances should a cable operator be allowed to carry more than the absolute number of vertically integrated program services owned as of February 9, 1993.[203]

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200 47 U.S.C. § 534.

201 47 U.S.C. § 532.

202 NCTA Comments at 25-28; Time Warner Comments at 48-50; TCI Comments at 31-34; Discovery Comments at 18; Liberty Media Comments at 21-24.

203 INTV Comments at 12.

207. Discussion. We tentatively propose to adopt a 40% limitation on the number of channels that can be occupied by vertically integrated programming.[204] We also propose to allow carriage of additional vertically integrated programming services, beyond the 40% limit, if such services are minority-controlled or are targeted to a minority audience.[205] We ask commenters to indicate whether allowing such expanded carriage of minority-controlled or minority oriented programming services will encourage additional minority ownership thereby increasing the diversity of programming. We also ask commenters to indicate whether the definition of "qualified minority programming source" in the leased access provisions of the Communications Act would be appropriate for this purpose.[206]

208. In determining the specific percentage level at which to establish channel occupancy limits, we must balance Congress' goals of increasing diversity and reducing the incentive and ability of vertically integrated cable operators to favor their affiliated programming, with the benefits and efficiencies associated with vertical integration. As Congress recognized, and the record in this proceeding confirms, there are significant benefits to cable subscribers which result from vertical integration. First, MSO investment in cable programming services has provided cable subscribers with a variety of high quality cable programming services. Many of the most popular cable programming services such as CNN, BET, The Discovery Channel, Nickelodeon and MTV were initiated or sustained with the help of MSO investment. Second, vertical integration between cable operators and programming services produces significant efficiencies in the

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204 We note, however, that the appropriate percentage limitation for channel occupancy limits is dependent upon the attribution standard we ultimately adopt to define vertical integration, and on other issues regarding the application of the channel occupancy limits to particular types of programming.

205 Commenters generally did not address this issue. However, E! Entertainment does suggest that the channel occupancy limits should not apply to services that have unique formats. E! Entertainment defines unique services as programmers that produce more than 30% of their own original programming or which are targeted to small specialized audiences (i.e., minorities or foreign language speakers). According to E! Entertainment, such channels serve the needs of viewers not otherwise served and thus warrant special treatment under the channel occupancy restrictions. E! Entertainment Comments at 8-9. We note that there is also precedent for such an exception in the leased access provisions of the Communications Act, which contain a similar exception allowing cable operators to use channel capacity designated for commercial use for the provision of programming from qualified minority (or educational) programming sources, regardless of whether such programming is vertically integrated. 47 U.S.C. § 532(i)(1).

206 47 U.S.C. § 532(i)(2) defines "qualified minority programming source" as a programming source "which devotes substantially all of its programming to coverage of minority viewpoints, or to programming directed at members of minority groups, and which is over 50% minority-owned."

distribution, marketing, and purchase of programming.[207] Third, vertical integration results in lower programming costs, which in turn results in lower subscriber fees and lower cable rates for subscribers. Fourth, vertical integration fosters investment in more innovative and riskier programming services.

209. In addition, Congress directed the Commission not to adopt limitations "which would impair the development of diverse and high quality video programming."[208] In this regard we note that cable operators are already required to reserve a substantial percentage of their channel capacity for carriage of local broadcast and PBG stations.[209] In addition, cable operators are subject to leased access requirements, pursuant to which they may be required to designate an additional 15% of their activated channel capacity for commercial use by programmers unaffiliated with the cable operator.[210] Significantly, the leased access obligations are parallel in purpose to the channel occupancy requirements, since they also obligate cable operators to provide system access to unaffiliated video programers. Thus, cable operators ability to carry affiliated programming is already significantly curtailed by statutorily mandated carriage obligations.

210. We also note that channel occupancy limits are not the only means by which Congress intended to prevent discrimination by vertically integrated MSOs. Sections 12 and 19 of the 1992 Cable Act establish specific behavioral restrictions prohibiting discrimination by vertically integrated cable operators and programming services. The Commission recently adopted strict regulations to implement Section 19 of the 1992 Cable Act.[211] As we indicated above, these provisions impose more narrowly tailored behavioral restraints, specifically prohibiting anti-competitive conduct by vertically integrated cable operators and programmers, while channel occupancy limits impose broader structural constraints, which affect the ability of all cable operators to carry programming in which they have an attributable interest.

211. In light of the foregoing, we believe that the 40% channel occupancy limit we propose is appropriate to preserve the benefits associated with vertical integration, while reducing cable operators' incentive and ability to favor their affiliated programmers. We invite

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207 See Besen Study (attached at TCI comments) at 23-24.

208 47 U.S.C. § 533 (f)(2)(G).

209 Cable operators with more than 12 channels may be required to reserve 33% of their activated channel capacity for local broadcast and PBG channels. See 47 U.S.C. §§ 531, 534, 535.

210 47 U.S.C. § 532.

211 Implementation of Section 12 of the 1992 Cable Act is still pending.

additional comment on whether such a limit is reasonable, given the structure of the marketplace and the other carriage obligations already imposed on cable operators. We ask commenters to indicate whether a 40% limit will adversely affect continued MSO investment in the development of new and innovative programming services. We also ask commenters to indicate how carriage of vertically integrated programming services will be affected by the establishment of a 40% limit. In addition, we seek comment on whether channel occupancy limits should vary depending on system capacity as is the case with must-carry, leased access, and noncommercial educational carriage requirements.

F. Treatment of Pay Channels, Multiplexed Channels and Local and Regional Networks.

212. Notice. In the Notice we asked commenters to indicate how pay-channels, multiplexed channels and regional programming networks should be treated for purposes of calculating the channel occupancy limits since relatively few subscribers purchase these services.

213. Comments. Cable commenters addressing this issue argue that vertically integrated regional networks, pay-per-view, pay-per-channel, and multiplexed channels should be exempt from the channel occupancy limits.[212] According to these commenters, since pay channels are not used by all subscribers, such channels should not be counted against the cable operator's channel occupancy limit.[213] With respect to multiplexed channels, cable commenters argue that cable operators engage in multiplexing only when they have the additional unused capacity to do so, and thus the existence of multiplexed channels suggests that a system operator is already carrying a full array of programming.

214. Several commenters argue that the channel occupancy limits should not apply to local or regional vertically integrated programming

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212 NCTA at Comments at 31; Liberty Media Comments at 24; Time Warner Comments at 43-45; IFE Comments at 9.

213 Time Warner asserts that only a fraction of a system's subscribers receive pay-per-view and pay-per-channel services, but cable operators must nonetheless reserve a channel throughout the system to make such services available to subscribers who desire them. Therefore, Time Warner submits that such services should not count against the overall channel occupancy limit. Time Warner suggests that applying channel occupancy limits to pay channels would force operators to choose between basic channels, received by many, and premium channels, received by a few. Alternatively, Time Warner proposes that pay channels and premium channels should be counted based on the percentage of a system's subscribers who actually subscribe to such services. Time Warner Comments at 43-44.

networks.[214] These commenters submit that there is no evidence demonstrating that cable operators favor affiliated regional programming networks over unaffiliated programming services. Moreover, commenters favoring an exemption for local and regional cable networks maintain that such networks are developed in order to respond to the needs and tastes of local subscribers and that subjecting such networks to channel occupancy limits would discourage MSOs from investing in the development of such services.

215. INTV on the other hand, maintains that pay-per-view, pay-per-channel and multiplexed channels should all be counted towards the channel occupancy limits, since these channels are occupied by vertically integrated programming, which Congress sought to limit.[215] Turner agrees that multiplexed channels should each be counted against the channel occupancy limit, since such use of channel capacity does not contribute to diversity. In this regard, Turner submits that time diversity is not relevant to Congress' objectives in requiring such a restriction.

216. Several commenters suggest other types of programming exemptions. Discovery and Cablevision Systems, for example, assert that carriage of new program services should be exempt for a period of five years so that such programs can become established in the national marketplace.[216] Several commenters also favor adoption of an exemption for popular programming (i.e., programming carried on unaffiliated systems serving at least 50% of subscribers nationwide) since such programming could not reasonably be said to be carried as a result of discriminatory practices.[217]

217. Discussion. We propose to count all vertically integrated pay-per-view and pay-per-channel services against a system's channel occupancy limits. While we recognize that such channels are used by a relatively small number of subscribers, they nonetheless occupy channel space that might otherwise be available to unaffiliated programming services. Moreover, since pay-per-channel and pay-per-view services are exempted from rate regulation under the 1992 Cable Act, it seems unlikely that cable operators will drop such services to provide other types of programming as is suggested by some commenters. Accordingly, we believe that such pay services should be counted towards the overall limits on vertically integrated programming.

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214 Time Warner Comments at 43-45; Cablevision Systems Comments at 12; Viacom Comments at 11-13; Affiliated Regional Communications, Ltd. Comments at 4; TCI Comments at 36-37; Liberty Media Comments at 26.

215 INTV Comments at 11.

216 Discovery Comments at 18; Cablevision Systems Comments at 11; Viacom Comments at 9; Liberty Media Comments at 29.

217 Discovery at Comments 18; NCTA Comments at 34; Turner Comments at 18; Viacom Comments at 4-6; Time Warner Comments at 54.