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August 26, 1993

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

William F. Caton, Acting Secretary  
Federal Communications Commission  
Washington, D.C. 20554

In re: MM Docket No. 92-266

Dear Mr. Caton:

On August 20, 1993, the undersigned and Dr. Walter Ciciora of Time Warner Entertainment Company, L.P. ("Time Warner") met with Robert Corn-Revere, Esq. of Chairman Quello's office regarding the issue of regulation of cable equipment as presented in the above-referenced proceeding. This letter, which summarizes the substance of that presentation, is being provided in accordance with Section 1.1206(a)(2) of the Commission's rules.

- 1) The "actual cost" pricing methodology should not apply to cable equipment installed only when a subscriber elects to purchase unregulated per-channel or per-program video services, even if such equipment also incidentally passes signals on the basic service tier.

Basic cable service is almost universally offered on an unscrambled basis without the need for any terminal equipment. A relatively inexpensive converter box may be required by some basic subscribers to address reception problems beyond the control of the cable operator, i.e.,

- a) The subscriber's television receiver is incapable of tuning the full spectrum of cable signals;

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- b) broadcasters have elected carriage on channels outside the contiguous basic band offered by the cable system; or
- c) the subscriber's television receiver suffers from direct pick up interference.

Such simple tuning devices made available by the cable operator properly fall within the scope of Section 623(b)(3) of the 1992 Cable Act.

In contrast, addressable boxes, which are used primarily to receive per-channel services, provide sophisticated electronic technology and signal security features which go beyond the simple tuner extension function of basic converters. Accordingly, addressable boxes are more expensive than converter boxes and the cable operator will provide addressable terminals only to those subscribers whose level of service demands addressability. If an addressable box is provided only to subscribers who desire per-channel services, the equipment rate charged to that subscriber should not be subject to rate regulation (except as required by the anti buy-through requirement).

Further, technological progress will surely suffer if the rates for sophisticated addressable equipment are subject to such regulation. The fact that an addressable box passes the signals from all service categories -- basic, cable programming, and per-channel -- is merely a consumer-friendly convenience which avoids the need to provide an A/B switch or, indeed, even a second set-top converter. Moreover, innovation in equipment technology demands the economic incentives of free market pricing; actual cost rate regulation would be a cumbersome and inadequate substitute. Indeed, if the Commission fails to reconsider its position that all equipment that passes basic tier signals is subject to "actual cost" based regulation, it is likely to create a marketplace incentive for the development of equipment that passes only cable programming or per-channel services. Such a result would be a step backward, not a step forward, for the consumer.

- 2) Only the entry-level descrambler should be regulated in accordance with the anti buy-through requirement.

Time Warner recognizes that the approach advocated above could result in allowing the same addressable box to be unregulated when provided to a cable programming service (tier) subscriber electing premium services, yet regulated when provided

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to the basic-only subscriber electing to exercise her rights under the anti buy-through provision, Sec. 623(b)(8). Some have labeled such a result anomalous. To the contrary, Time Warner believes this result fully supports its reading of the statute.

The 1992 Cable Act clearly distinguishes between regulation of rates for equipment used to receive basic service and equipment used to receive per-channel service. On the one hand, the Act seeks to ensure that equipment rates for basic subscribers are reasonable, which is consistent with the mandate for a reasonable basic service package, i.e., service plus equipment. In contrast, the 1992 Cable Act does not require the regulation of rates for equipment used to receive per-channel services, which is consistent with the general exemption from rate regulation of per-channel services.

Section 623(b)(3)(A) of the 1992 Cable Act specifically limits actual-cost based equipment regulation to two classes of basic equipment: (1) equipment "used by subscribers to receive the basic service tier," and (2) equipment required for a basic-only subscriber to receive programming on a per-channel or per-program basis pursuant to the anti buy-through provision. If Congress intended all equipment to be priced based on actual cost, there would have been no need to specify that rates applicable to descrambling equipment used to receive pay services by a basic-only subscriber are subject to actual cost regulation. Rather, Congress must have intended that equipment required for nonbasic subscribers to receive per-channel service, e.g. an addressable box, would be unregulated, even if this more advanced equipment also tunes the basic tier signals. Moreover, given that many of the service options offered by addressable boxes and other innovative pieces of equipment are far removed from basic cable service, it is plain that Congress could not have intended for the Commission's efforts to keep basic rates reasonable to include the regulation of such equipment.

In this regard, Time Warner urges the Commission to clarify that a cable operator's obligations under the anti buy-through clause are satisfied if an entry-level descrambler is made available, at a rate set in accordance with Sec. 623(b)(3), so that the basic-only subscriber is able to receive any per-channel or per-program offerings provided pursuant to Sec. 623(b)(8). In other words, the cable operator should only be forced to provide, "on the basis of actual cost," equipment with the minimum level of sophistication as is "required to access programming described in paragraph (8)" (anti buy-through). If the basic-only customer elects more sophisticated equipment, with additional "bells and whistles," such equipment should be unregulated as long as the

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subscriber had the option to receive the more simple, regulated box.

- 3) Modular devices which plug into basic equipment are unregulated if the basic signals do not pass through such devices.

The Commission should clarify that the "used to receive basic service" test applies only to equipment through which the regulated basic signals actually pass. Thus, for example, a basic converter might be designed to include a decoder interface plug, as advocated by the Cable-Consumer Electronics Compatibility Advisory Group in ET Docket No. 93-7. Thus, cable operators would have the flexibility to develop innovative unregulated equipment which subscribers might elect to lease from the operator due to the enhanced functionalities such equipment might provide, while at the same time the equipment actually used to receive basic service would be provided at a regulated rate pursuant to Sec. 623(b).

For example, several equipment providers have begun to offer personal computing modules that would be integrated into the converter box. These experimental modules will offer such services as interactive home shopping, interaction with multimedia databases, or these modules can serve as a platform from which the cable operator can decide which software packages to offer. See, "GI, Intel, Microsoft Ink Set-top/Converter Deal," Multichannel News, vol. 14, no. 18, pp. 1, 45 (May 3, 1993); Associated Press Online Service, EDT V0963 (New York, June 13, 1993) (Companies expected to propose hardware and software computing services for set-tops). Obviously, Congress could not have meant for this burgeoning technology to be regulated like the simple tuning equipment provided for basic tier services pursuant to Section 612(b)(3). If the Commission acts quickly to clarify this issue, it will create an incentive for manufacturers to develop regulated cable equipment which includes an interface plug so that consumers will have the option to enhance such equipment with additional innovations as they are developed, provide for compatibility in a transparent, consumer-friendly fashion, while avoiding disincentives to the creation of these multimedia or interactive devices by improperly expanding the scope of equipment rate regulation beyond the requirements of Sec. 612(B)(3).

- 4) Digital equipment should not be regulated if all regulated services are provided in analog format.

As the Commission is aware from its Advanced Television proceedings, the development of digital compression techniques for television is extremely complex and costly, while nevertheless holding the promise for a new generation of television with vastly improved performance and superior spectrum efficiency. In order to encourage the development of digital television, the Commission should determine that Sec. 623(b) was intended to apply only to the analog television universe which existed at the time Congress adopted the statute.<sup>1</sup> Thus, digital equipment would not be subject to the "actual cost" requirement of Sec. 623(b) so long as all regulated basic and cable programming video services are provided in an analog format, and so long as the subscriber has the option to lease, on a fully regulated basis, any analog terminal equipment used to receive such regulated analog services.

5) Equipment sales should not be regulated.

Finally, Time Warner requests that the Commission reconsider its decision in ¶ 298 of the Order that the sale of equipment by cable operators is subject to actual cost regulation. The 1992 Cable Act provides for the regulation of rates for the installation and lease of equipment; it does not address regulation of the sale of equipment. Therefore, the Commission is not empowered to establish such rate regulation. Further, there is no public interest justification for such regulation since there already exists an especially competitive national market for the type of cable equipment that would be sold by cable operators to subscribers. Indeed, if cable operators were forced to sell equipment at actual cost, competitive suppliers would be unlikely to survive since they would be forced to sell below cost. This would directly contravene Congressional directives for the Commission to promote the commercial availability of converter boxes and remote control devices. See Sec. 624A(c)(2)(C) of the 1992 Cable Act.

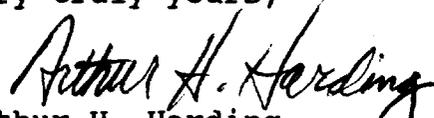
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<sup>1</sup>Such an interpretation would be wholly consistent with the Commission's interpretation of the term "video programming" in the 1984 Cable Act. See Video Dialtone Order, 7 FCC Rcd at 5820.

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Please associate this letter with the above-referenced docket.

Very truly yours,

A handwritten signature in cursive script that reads "Arthur H. Harding". The signature is written in dark ink and is positioned above the typed name.

Arthur H. Harding  
Counsel for Time Warner  
Entertainment Company, L.P.

AHH/sbc/9525  
cc: Robert Corn-Revere, Esq.