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BEFORE THE

Federal Communications Commission

WASHINGTON, D. C.

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of	)	
	)	
Implementation of Sections 11 and 13 of the Cable Television Consumer Protection and Competition Act of 1992	)	MM Docket No. 92-264
	)	
Horizontal and Vertical Ownership Limits, Cross Ownership Limitations and Anti-trafficking Provisions	)	
	)	
Further Notice of Proposed Rule Making	)	

REPLY COMMENTS OF TELE-COMMUNICATIONS, INC. ON FURTHER NOTICE

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SUMMARY

TCI supports a subscriber limit of 35% or higher and a channel occupancy limit of at least 40%. The record contains substantial economic, antitrust, and public policy analyses, as well as marketplace evidence supporting these limits. More restrictive limits will create significant disincentives for investment in new technologies and innovative program services.

Conversely, the few parties advocating lower ownership limits provided no evidence upon which the Commission could base the adoption of such lower limits. They simply asserted their desire for lower limits and, at most, offered sporadic, anecdotal evidence. Thus, the Commission does not have before it a record that will support limits lower than those proposed by TCI.

TCI also urges the Commission to clarify that its subscriber limit does not prohibit a cable company from growing as the communities it already serves grow.

Further, the Commission should reject NATOA's proposal to limit the local/regional channel occupancy exemption to noncommercial, not-for-profit networks. Such a limitation will stifle the very incentives to develop new local and regional networks that the Commission wishes to create.

Finally, TCI supports the use of system bandwidth to calculate channel occupancy limits. The constant fluctuations in useable system capacity inherent in a digitally compressed environment necessitate such an objectively precise and adaptive measurement approach.

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In the Matter of Implementation of Sections 11 and 13 of the Cable Television Consumer Protection and Competition Act of 1992 Horizontal and Vertical Ownership Limits, Cross Ownership Limitations and Anti-trafficking Provisions Further Notice of Proposed Rule Making	)	MM Docket No. 92-264

REPLY COMMENTS OF TELE-COMMUNICATIONS, INC. ON FURTHER NOTICE

Tele-Communications, Inc. ("TCI") hereby files its Reply Comments on the Commission's Further Notice of Proposed Rule Making in the above-captioned proceeding.[1] TCI reiterates its support for a subscriber limit of 35% or higher and a channel occupancy limit of at least 40%. TCI and others submitted extensive economic and public policy evidence that fully supports

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[1] Implementation of Sections 11 and 13 of the Cable Television Consumer Protection and Competition Act of 1992, Horizontal and Vertical Ownership Limits, Cross-Ownership Limitations and Anti-Trafficking Provisions, Report and Order and Further Notice of Proposed Rule Making, MM Docket No. 92-264, FCC 93-332 (released July 23, 1993) ("Further Notice").

these proposals. Conversely, the few parties that advocated lower ownership limits did not provide any significant evidence upon which the Commission reasonably could base the adoption of such lower limits. They simply asserted their desire for lower limits and, at most, offered sporadic and anecdotal evidence. Thus, the Commission does not have before it a record that will support limits lower than those proposed by TCI.

I. SUBSCRIBER (HORIZONTAL) LIMIT

A. Record Support for a Subscriber Limit of 35% Or Higher Is Substantial

Consistent with previous Comments in this proceeding, the Comments submitted in response to the Further Notice widely support a horizontal limit of 35% or higher.[2] TCI and other commenters submitted voluminous evidence to support such a limit, including:

- expert economic analysis, including a detailed study prepared by Stanley M. Besen et al., demonstrating that TCI's proposed subscriber limit would increase the quality and diversity of programming and create strong incentives to invest in technology;[3]

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[2] See, e.g., Liberty Media at 8-12; NCTA at 7-9; TCI at 10-18; Time Warner at 6-10.

[3] See, e.g., TCI at 13-15; Stanley M. Besen, Steven R. Brenner, John R. Woodbury, "An Economic Analysis of the FCC's Proposed Cable Ownership Restrictions," February 9, 1993 (attached to TCI's Comments on NPRM and TCI's Comments on Further Notice) ("Besen et al.") at 5-22.

- a review of antitrust jurisprudence and scholarship which supports a subscriber limit well in excess of 35%;[4]

- concrete examples of many other industries where market share has substantially exceeded 50% of a national market;[5]

- specific instances of successful programming services that have maintained their popularity at relatively low penetration, thus proving unfounded any concern that a single cable operator with a subscriber limit of 35% or greater could foreclose access to a marketplace;[6] and

- practical examples of the investments TCI and others in the cable industry are making toward the development of a broadband telecommunications infrastructure, along with economic analysis demonstrating that restrictions on moderate growth threaten the continuation of such investments.[7]

In contrast, only MPAA and NATOA proposed a subscriber limit below 35% and their proposals are almost entirely conclusory in nature and are predicated on minimal and anecdotal evidence. Neither MPAA nor NATOA disputed the findings and conclusions in the Besen economic analysis. Neither offered a contrary view of the antitrust learning. Neither offered examples from other industries with ownership limits at or near their proposals.

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4 See, e.g., NCTA at 7; TCI at 15-16; Time Warner at 6; 9-10.

5 TCI at 16-17.

6 See, e.g., NCTA at 7 and n. 14; TCI at 17; Time Warner Comments on NPRM at 28-29.

7 See, e.g., NCTA at 8; TCI at 1-8; 13-14.

Neither disagreed that, absent restrictive regulations, the cable industry will contribute significantly to the construction of a broadband telecommunications infrastructure. Instead, MPAA and NATOA merely state their desire for a lower subscriber limit.

NATOA, for example, simply asserts its "belief" that "a subscriber limit over 25% would negate any benefit that such a limit would engender, since an MSO that were to reach over 25% of the nation's cable homes would wield excessive market power."[8] NATOA states no basis, cites no evidence, and offers no rationale for this assertion or for its burdensome horizontal proposal.

Similarly, MPAA urges the Commission to adopt a "prophylactic" 25% horizontal limit because "there are no compelling public interest reasons for a higher number, and certainly none that outweigh the diversity goals established by the Congress."[9] This conclusory statement ignores completely the substantial benefits and efficiencies that cable consolidation has produced and which the Commission and Congress have long recognized.

For example, the Commission's 1990 Cable Report found that higher concentration levels enable cable companies to take advantage of economies of scale and foster investment in more and better original programming and a wealth of viewing options for consumers. It further found that the growth of MSOs generates significant efficiencies in administration, distribution, and

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8 NATOA at 14.

9 MPAA at 2-3.

procurement of programming which can promote the introduction of new programming services.[10] Similarly, the legislative history of the 1992 Cable Act clearly recognized that horizontal concentration may reduce programmers' transaction costs by eliminating the need for negotiation with each of the thousands of local cable systems throughout the country.[11] Congress also acknowledged that horizontal concentration may help promote the introduction of new services into an increasingly competitive market by providing capital and a ready subscriber base for such new services.[12]

Finally, as TCI has previously described, the cable industry is well positioned to contribute substantially to the development of the broadband telecommunications infrastructure which the Administration, Congress, and the Commission have identified as a principal telecommunications policy goal of the 1990's. Given the extremely dynamic state of the marketplace, it would be nonsensical to adopt rules that prohibit moderate growth in an industry that is expected to play a key role in the development of that infrastructure.

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10 See 1990 Cable Report, 5 FCC Rcd 4962, 5009 (1990). See also House Report at 43.

11 House Report at 43. See also Senate Report at 33.

12 House Report at 43. See also Ownership Notice at ¶ 34.

Thus, contrary to MPAA's claim, there are "compelling public interest reasons for a higher number [than 25%]."[13] By disregarding these myriad public interest reasons and consumer benefits, both NATOA and MPAA have, in fact, ignored Congress' desire for a horizontal limit which "account[s] for any efficiencies and other benefits that might be gained through increased ownership or control" and which "reflect[s] the dynamic nature of the communications marketplace."[14] They have preferred instead merely to intone the widely rejected and insupportable mantra that "big is bad."

In light of the substantial evidence in the record supporting a limit of 35% or higher and the absence of any contrary showing of abuse of market power, TCI submits that the Commission is compelled to establish a horizontal limit of at least 35%, the high end of the range proposed in the Further Notice.[15] Indeed, because those entities proposing a low

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13 MPAA's assertion that companies with market shares no greater than 6% have invested in programming and technology, MPAA at 3 and nn. 6-7, in no way demonstrates that a subscriber limit of 25% is appropriate. To the contrary, it is well understood that there exist scale effects that encourage larger firms to invest proportionately more in research and development than smaller firms. See F.M. Scherer and D. Ross, Industrial Market Structure and Economic Performance, Third Edition, Boston: Houghton Mifflin, 1990, at 652. Thus, if the Commission adopts a subscriber limit that does not permit moderate growth, the sacrifice to R&D investment will be considerable.

14 Communications Act §§ 613(f)(2)(D-E), 47 U.S.C. §§ 533(f)(2)(D-E).

15 Further Notice at ¶ 148. This horizontal limit also comports with the Commission's longstanding reluctance to impose regulatory burdens on firms without a solid record to support (continued...)

subscriber limit offer no supporting economic evidence, it would be arbitrary and capricious for the Commission to adopt such a limit.

B. The Ability of Program Services to Succeed with Penetration Levels of 40% Or Less Fully Supports a Subscriber Limit of 35% Or Higher

The Commission[16] and others[17] have noted that many program services have succeeded in the marketplace with penetration levels below 40%. Thus, even if a single cable operator were to achieve a subscriber limit of 60%, far above TCI's proposed limit, it still would not be able unilaterally to deny enough subscribers to a program service to threaten its economic success.

In its Comments, MPAA asserts that it is significant that program services that have succeeded with relatively small penetration are vertically integrated.[18] However, that

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[15](...continued) such an action. See, e.g., Amendment of Part 90 Regarding Use of the 800 MHz Band for Mobile Radio Communications, 95 F.C.C.2d 477, 497 at ¶ 46 (1983) ("The Commission is reluctant to impose such a burden on manufacturers [to establish a separate subsidiary to operate trunked SMR systems] without a solid record to support such an action"). This policy of avoiding the imposition of regulatory burdens absent solid record support obtains with even greater force in this context since Congress specifically accorded the Commission wide discretion in crafting a horizontal limit, see Senate Report at 80, and instructed the Commission to "not impose limitations which would impair the development of diverse and high quality video programming." Communications Act § 613(f)(2)(G), 47 U.S.C. § 533(f)(2)(G).

[16] Further Notice at n. 128.

[17] See, e.g., TCI Comments on NPRM at 24-25; Time Warner Comments on NPRM at 28-29.

[18] MPAA at n. 9.

assertion is inaccurate. As TCI has shown, there are non-vertically integrated program services that have succeeded with penetration levels below 40%.[19]

Moreover, it is irrelevant that successful program services with relatively low penetration are vertically integrated. A cable operator's incentive to carry or not carry a program service is dependent upon the value that service provides to subscribers. Programming drives the cable business and, therefore, operators base programming choices on what their customers want, not on whether the service is vertically integrated with the operator or with any other operator. There may be other reasons to explain why a number of vertically integrated programmers are able to succeed with relatively low penetration, but as long as no single cable company can itself deny enough subscribers to a program service to undermine its economic viability, the level of horizontal concentration does not create a risk of foreclosure. Thus, contrary to MPAA's assertion, the evidence concerning the ability of program services to succeed with relatively low penetration fully supports TCI's proposed subscriber limit.

C. The Commission's Subscriber Limit Should Not Prohibit Cable Companies from Growing With the Communities They Already Serve

The Commission has found that there is evidence in the record to support "future MSO growth without precluding the

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19 For example, Telemundo and Bravo have had success with penetration levels below 40%.

launch or success of new programming services."[20] TCI supports this finding.

Generally, there are two ways in which a cable company could grow horizontally. First, it could acquire unaffiliated cable systems. For the reasons cited above and in its earlier Comments in this proceeding, TCI believes the Commission should establish a subscriber limit that permits moderate growth through acquisition.

Second, a cable company could grow as the community it serves grows in size and population. In this circumstance, it is particularly important that the Commission's limit not prohibit growth. Without such an interpretation, the Commission's horizontal limit could lead to unintended and undesirable results.

As communities grow, cable companies will extend service to those new homes. Indeed, in typical cases, they will be required by their franchises to do so. Yet, if a company is near or at the Commission's limit, it could be required to divest its operations in another market merely to continue to provide service in the first. Clearly, such a result was not intended by Congress whose overriding objectives in passing the 1992 Cable Act included promoting "the availability to the public of a diversity of views and information through cable television"[21] and avoiding rules which would "require divestiture by any cable

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20 Further Notice at ¶ 148.

21 1992 Cable Act § 2(b)(1).

operator."[22] In order to fully achieve these goals, the Commission should make clear that the subscriber limit it adopts is intended to permit reasonable growth up to the limit through acquisition, but is not intended to prohibit cable operators from growing with the communities they already serve as those communities continue to grow.

II. CHANNEL OCCUPANCY (VERTICAL) LIMIT

A. Record Support for a Channel Occupancy Limit of At Least 40% Is Substantial

Numerous Comments support a vertical limit of at least 40%,[23] citing expert economic analysis,[24] antitrust jurisprudence and scholarship,[25] marketplace facts demonstrating that vertical integration has in no way diminished the ability of unaffiliated program services to obtain carriage on cable systems,[26] and previous Cable Act Orders, particularly the Program Access Order, whose strict provisions for deterring

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22 Further Notice at ¶ 147 (citing Senate Report at 34).

23 See, e.g., E! Entertainment at 3; NCTA at 20; Pay-per-view Network at 5-9; Rainbow Programming Holdings at 4; TCI at 24-32; Turner Broadcasting at 6; Viacom at 2 (advocating a 50% vertical limit).

24 See, e.g., TCI at 28-29; Besen et al. at 23-43.

25 See, e.g., TCI Comments on NPRM at 33-34.

26 Id. at 30.

vertical foreclosure eliminate the need for a vertical limit below 40%.[27]

By contrast, only MPAA and NATOA propose a more restrictive vertical limit. MPAA endorses a vertical limit of 20%, while NATOA nominally endorses a 40% limit but then proceeds to attenuate the effectiveness of such a limit by proposing an insupportable calculation methodology.[28] Once again, NATOA and MPAA fail to respond to the specific economic and antitrust analyses and marketplace evidence cited by TCI and others which clearly demonstrate the benefits and efficiencies produced by vertical integration and the difficulties of engaging in vertical foreclosure strategies. Rather, NATOA and MPAA rely on unsubstantiated assertions and minimal anecdotal illustrations in support of their proposals for an overly restrictive vertical limit. TCI respectfully submits that the Commission should continue to disregard such groundless, self-serving proposals.

In particular, TCI joins the overwhelming majority of commenters who urge the Commission not to count pay-per-view,

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[27] See, e.g., E! Entertainment Comments on NPRM at 2-3; Liberty Comments on NPRM at 20; NCTA Comments on NPRM at 27; TCI at 25-28; Viacom Further Reply Comments on NPRM at 4.

[28] NATOA at 6-12. NATOA's onerous calculation methodology includes: subtracting PEG, over-the-air broadcast, and non-video channels from all activated channels; counting pay-per-view and pay-per-channel programming against the permitted number of affiliated channels; diluting the local/regional exemption by limiting it to noncommercial, not-for-profit networks; denying a new programming exception; opposing a channel occupancy threshold; opposing the elimination of a vertical limit where effective competition develops; and opposing the grandfathering of existing carriage relationships.

pay-per-channel, multiplexed, and non-video services against the permitted number of affiliated channels.[29] These commenters presented substantial legal and economic rationales to support their positions and clearly demonstrated that application of the proposed channel occupancy limit to these innovative offerings would cause major programming disruptions to certain cable systems and would create significant obstacles to realizing the full promise of emerging cable technology and programming diversity. TCI concurs fully in these views.

In the sections below, TCI addresses specific flaws with the MPAA and NATOA proposals.

B. Contrary to MPAA's Claims, Application of a 40% Channel Occupancy Limit Will Not Restrict Carriage of Unaffiliated Programming

In an attachment to its Comments, MPAA provides two examples of the application of the 40% vertical limit to a 36 channel and 54 channel TCI system. MPAA concludes that application of this limit demonstrates that "it would be possible for a substantial number of [36 channel] TCI systems to comply with the proposed rule while carrying <u>no</u> unaffiliated programming."[30] Application to 54 channel systems, argues MPAA, would result in "<u>as few as five</u> unaffiliated programming networks."[31]

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29 <u>See</u>, <u>e.g.</u>, Encore at 2-10; Liberty Media at 16-17; NCTA at 14-15; 22-23; Pay-Per-View Network at 5-9; Time Warner at 25-30; Viacom at n. 2.

30 MPAA at 8.

31 <u>Id.</u> (emphases in original).

MPAA is apparently concerned that after a cable operator meets its must carry, PEG access, and other mandatory carriage obligations, it will have insufficient capacity for the carriage of unaffiliated services. However, because TCI and other cable operators have historically carried broadcast signals and set aside channels for PEG access, if such concern were valid, MPAA should be able to show concrete examples of carriage problems in the marketplace. MPAA makes no such showing. In fact, marketplace facts demonstrate that no such problems exist.

For example, many services unaffiliated with TCI, such as the Nashville Network, Lifetime, the USA Network, and ESPN, have nearly universal carriage on TCI cable systems. By contrast, a number of services in which TCI has an attributable interest, such as the Learning Channel, Courtroom Television Network, and E! Entertainment, are carried on less than one-third of TCI's systems. It is worth noting that the USA Network, which is owned by two MPAA members, has substantially wider distribution on TCI systems than several program services in which TCI has an attributable interest.

These facts confirm TCI's earlier assertion that cable operators base programming decisions on the perceived value of the programming by consumers rather than on whether such programming is affiliated or unaffiliated with the operator.

Moreover, in the near future the Commission is expected to adopt "program carriage" rules designed to prohibit a cable operator from "unreasonably restrain[ing] the ability of an unaffiliated video programming vendor to compete fairly by discriminating in video program distribution on the basis of affiliation or nonaffiliation ...."[32] Thus, MPAA's suggestion that a low channel occupancy limit is necessary to ensure carriage of programming unaffiliated with the cable operator is not only unfounded based on marketplace facts, but superfluous in light of other provisions of the 1992 Cable Act.

C. The Commission Should Reject NATOA's Proposed Limitation of the Local/Regional Exemption to Noncommercial, Not-For-Profit Networks

NATOA recommends that the Commission limit its proposed exemption for local and regional networks to noncommercial, not-for-profit programming.[33] NATOA bases this recommendation on: 1) the erroneous assumption that "[m]ost local and regional networks offer primarily sports programming, and are part of large national conglomerates" and 2) a conclusory assertion that "there is no reason whatsoever for such programming to be excepted from the channel occupancy limits."[34] NATOA is wrong on both counts.

First, sports programming is but one example of the wide array of highly demanded services provided by local and regional networks. Moreover, as stated in its Comments, TCI believes that

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[32] Communications Act § 616(a)(3), 47 U.S.C. § 536(a)(3).

[33] NATOA at 9-10.

[34] Id. at 10.

regional news services and other regional services will proliferate over the next several years.[35]

More importantly, notwithstanding NATOA's "belief," the Commission has found substantial reasons for exempting local and regional networks from the channel occupancy limit. In the Further Notice, the Commission correctly noted that such an exemption "is necessary to encourage continued MSO investment in the development of local and regional cable networks."[36] The Commission continued that "[s]uch local and regional cable networks are responsive to the needs and tastes of local audiences and serve Congress' objectives of promoting localism."[37]

NATOA's proposed limitation of the local/regional exemption to noncommercial, not-for-profit entities would stifle the very incentives to develop new local and regional networks that the Commission wishes to create. Accordingly, the Commission should

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35 TCI at 34. The overwhelming majority of commenters on the Further Notice supported a local/regional exemption. See Affiliated Regional Communications at 1-8; Liberty Media at 15; NCTA at 21-22; Rainbow Programming Holdings at 9-10; Time Warner at 33; Turner Broadcasting at 7; Viacom at 8.

36 Further Notice at ¶ 219.

37 Id. (citing 1992 Cable Act § 2(a)(10) stating Congress' overriding policy to promote the local origination of programming). For similar reasons, the Commission proposed to adopt an exclusively national subscriber limit due to its concern that a regional limit might sacrifice, among other things, "development of local and regional cable programming...." Given NATOA's support for this Commission proposal, see NATOA at 14, its proposed limitation of the local/regional exemption is particularly confounding.

reject NATOA's proposal and exempt all local and regional programming from the channel occupancy limit.[38]

D. The Commission Should Use System Bandwidth to Calculate the Channel Occupancy Limit

In its previous filings, TCI noted that emerging technologies, such as digital video compression and fiber optics, will render obsolete the conventional method of counting channels whereby each program service equals one channel. TCI suggested that the best method for achieving Congress' goal of promoting diversity of programming while also sustaining cable operator incentives to invest in new technologies and innovative program services is to calculate the channel occupancy limit based on system bandwidth. Under this approach, the Commission would count each 6 MHz segment of bandwidth as a single unit for purposes of calculating the channel occupancy limit, regardless of the number of program services transmitted over any given 6 MHz segment.[39]

Most commenters support TCI's bandwidth proposal.[40] Only NATOA urges the Commission to "disregard the suggestion of TCI that the channel occupancy limits be measured based on

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[38] Additionally, TCI agrees with Time Warner and NCTA that the simplest method for "defining" local and regional programming services for purposes of this exemption would be to apply the channel occupancy limit only to programming services that are distributed nationally. See NCTA at 22; Time Warner at 34.

[39] TCI Comments at 36-50.

[40] See, e.g., Liberty Media at 16; NCTA at 17; Time Warner at 23-25; Turner Broadcasting at 4.

bandwidth."[41] NATOA argues that a bandwidth approach "would be directly contrary to the express language used by Congress" because the statute and legislative history discuss "limits on occupancy of 'channels.'" NATOA also contends that a bandwidth approach "would be more difficult to measure and enforce."[42] Once again, NATOA is mistaken on both counts.

First, as TCI demonstrated, far from being a new formulation "directly contrary" to Congress' express language, TCI's spectrum bandwidth proposal merely elucidates longstanding Congressional and Commission precedent which has already defined "cable channel" based on system bandwidth.[43]

Second, as TCI's policy analysis demonstrated, a "channel=program" approach simply will not work as a practical matter in an environment using digital compression. Rather, the constant fluctuations in useable system capacity inherent in a digitally compressed environment necessitate the use of the more objectively precise and adaptive system bandwidth measurement.[44]

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41 NATOA at n. 4.

42 Id.

43 TCI at 38-42.

44 Id. at 42-46.

CONCLUSION

For the foregoing reasons, TCI respectfully recommends that the Commission adopt vertical and horizontal ownership rules consistent with the Comments herein and with the Comments previously submitted by TCI in this proceeding.

Respectfully submitted,

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