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BEFORE THE

Federal Communications Commission

WASHINGTON, D.C.

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

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 Limitations	)	

OPPOSITION OF TELE-COMMUNICATIONS, INC.

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February 14, 1994

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SUMMARY

In adopting the subscriber and channel occupancy limits, the Commission carefully balanced the benefits of vertical and horizontal relationships against the perceived threat to competition that could result from unreasonably high vertical integration or horizontal concentration. The record in this proceeding contains substantial evidence that vertical and horizontal ownership allow firms to realize efficiencies and economies of scale which lower the firm's costs, thereby leading to greater investment in programming and technology.

Accordingly, the Commission should reject the extreme subscriber and channel occupancy limits proposed by the Center for Media Education/Consumer Federation of America ("CME/CFA"). CME/CFA focus entirely on the potential negative consequences of vertical and horizontal ownership, notwithstanding that Congress, the Commission, the courts, antitrust scholars, and economists have uniformly recognized that such ownership can enhance consumer welfare.

In addition, the Commission should:

- Reject CME/CFA's proposal to include telephone subscribers in the cable horizontal limit because it is inconsistent with the plain language of the 1992 Cable Act which requires limits on "the number of <u>cable subscribers</u> a person is authorized to reach <u>through cable systems</u>."

- Reaffirm its decision to apply the channel occupancy limit only up to 75 channels because the expanded channel capacity resulting from deployment of fiber optics and digital compression eliminates the need for the limit as a means of encouraging cable operators to carry unaffiliated programming services.

- Reaffirm its decision to grandfather existing carriage relationships from the channel occupancy limits in order to avoid creating consumer unhappiness and confusion caused by the loss of services consumers have grown accustomed to receiving.

- Reject CME/CFA's proposal to eliminate the single majority shareholder exception from the attribution rules because the proposal is inconsistent with longstanding Commission precedent recognizing that influence alone is insufficient to render a minority shareholder's interest cognizable.

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OPPOSITION OF TELE-COMMUNICATIONS, INC.

Tele-Communications, Inc. ("TCI") hereby opposes the Petition for Reconsideration of the Second Report and Order in the above-captioned proceeding filed by Center for Media Education/Consumer Federation of America ("CME/CFA").[1]

I. INTRODUCTION

The Commission's horizontal and vertical limits promote the public interest by carefully balancing the benefits of vertical and horizontal relationships against the perceived threat to competition that could result from unreasonably high vertical integration or horizontal concentration. The record in this proceeding contains substantial evidence that vertical and

[1] This Opposition is filed on Febuary 14, 1994, because the Commission was closed due to inclement weather on February 11, 1994, the original filing deadline.

horizontal ownership allow firms to realize efficiencies and economies of scale which lower the firms' costs, thereby leading to greater investment in programming and technology and satisfying Congress' and the Commission's program diversity and infrastructure goals.

In spite of this record, and the fact that a federal district court ruled the ownership provisions of the 1992 Act unconstitutional,[2] CME/CFA ask the Commission to consider a fifth round of comments on horizontal and vertical ownership. The only "new" development CME/CFA alludes to is a set of allegations made in connection with the proposed takeover of Paramount Communications Inc. by QVC. As shown below, allegations made in such a context do not justify alteration of the Commission's regulations.

The principal problem with the CME/CFA position is that it does not attempt to balance the pros and cons of vertical integration and horizontal concentration. TCI recognizes that there are legitimate issues raised about the effects of vertical and horizontal ownership. At the same time, Congress, the Commission, the courts, antitrust scholars and economists have uniformly recognized that such ownership can enhance consumer welfare. But CME/CFA focuses entirely on the potential negative consequences of vertical integration and horizontal

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[2] Daniels Cablevision, Inc. v. United States of America, 835 F. Supp. 1 (D.D.C. 1993).

concentration. Such a myopic approach naturally produces absurdly low recommendations.

The Commission adopted ownership limits that are reasonable based on the voluminous evidence before it. It should reaffirm those limits and reject the extreme and unsupportable proposals of CME/CFA.

II. THE COMMISSION'S SUBSCRIBER LIMIT IS CONSISTENT WITH ECONOMIC, LEGAL, AND PUBLIC POLICY PRECEDENT

CME/CFA claim that the Commission's 30% horizontal limit is too high, and ask the Commission to reduce permissible horizontal ownership to 10-20% of total homes passed.[3] CME/CFA completely ignore substantial record evidence demonstrating that a subscriber limit of 30% or higher promotes longstanding public policy goals and is consistent with economic, legal, and public policy precedent.[4] For example, the record includes the following:

- Expert economic analysis prepared by Stanley M. Besen <u>et al.</u> demonstrating that the Commission's limit does not raise competitive concerns: "neither the current level of horizontal concentration in cable ownership, nor an increase in that concentration, pose a

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3 CME/CFA Petition at 2-4.

4 <u>See</u>, <u>e.g.</u>, Comments filed by TCI in MM Docket No. 92-264 on February 9, 1993 and August 23, 1993.

substantial threat of increased market power and reduced program diversity."[5]

- Evidence showing that arbitrarily low subscriber limits (as well as low channel occupancy limits) will reduce investment in the development and distribution of national program services.[6]
- Analysis showing that horizontal ownership generates efficiencies and economies of scale in the development of new technologies that enhance consumer welfare and, in particular, advance Administration, Congressional and Commission goals relating to construction of the National Information Infrastructure.[7]
- An analysis of antitrust jurisprudence and scholarship showing that a single firm with a national market share substantially higher than the Commission's 30% limit does not create concerns that such firm will extract unreasonable concessions from its suppliers or will unfairly restrain competition among distributors of

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[5] Stanley M. Besen, Steven R. Brenner & John R. Woodbury, "An Economic Analysis of the FCC's Proposed Cable Ownership Restrictions" at 2, February 9, 1993 ("Besen" et al."). For convenience, the Besen et al. analysis is attached to this Opposition.

[6] See Second Report and Order, at ¶ 25; TCI Comments at 3 (February 9, 1993); Besen et al. at 8-9.

[7] TCI Comments at 6-9 (February 9, 1993).

programming.[8] In fact, courts have consistently held that market shares below 50% do not confer monopoly or monopsony power[9] and the Supreme Court's seminal Jefferson Parish decision held that a 30% market share was insufficient to confer market power.[10]

In reviewing this evidence, the Commission undertook the balancing of pros and cons which CME/CFA ignores in favor of an approach focused entirely on the perceived harm of vertical integration and horizontal concentration:[11]

> A 30% horizontal ownership limit is generally appropriate to prevent the nation's largest MSOs from gaining enhanced leverage from increased horizontal concentration. Nonetheless, it also ensures that the majority of MSOs continue to expand and benefit from the economies of scale necessary to encourage investment in new video programming services and the deployment of advanced cable technologies.[12]

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[8] See Comments of TCI in the Further Notice in this proceeding (filed August 23, 1993) at 15-18; see also I Antitrust Law Developments (Third), ABA Antitrust Section, 213-214 (3d ed. 1992).

[9] See, e.g., United States v. Aluminum Co. of America, 148 F. 2d 416 (2d Cir. 1945); In re Beef Industry Antitrust Litigation, 713 F. Supp. 971, 980 (N.D. Tex. 1989), a'ffd., 907 F. 2d 510, 514-516 (5th Cir. 1990); United States v. Syufy Enterprises, 903 F. 2d 659, 663-671 (9th Cir. 1990).

[10] Jefferson Parish Hospital District No. 2 v. Hyde, 466 U.S. 2, 26-29 (1984).

[11] Second Report and Order at ¶ 25.

[12] Id. at ¶ 25. Contrary to CME/CFA's claim, the Commission did not adopt its 30% limitation to avoid a confrontation with TCI. CME/CFA Petition at 4-5. Rather, the Commission found no definitive evidence that existing levels of (continued...)

A. The Allegations Cited by CME/CFA Regarding TCI's Level of Market Power Are Wholly Unsupported

CME/CFA counters the Commission's careful weighing of the pros and cons of vertical integration and horizontal concentration with unsupported allegations made in two recently filed antitrust complaints and the self-interested testimony of a Viacom executive deeply enmeshed in the takeover battle for Paramount Communications.

It is well-established that a consent decree entered before any testimony is taken does not constitute evidence in any proceeding against the consenting defendant.[13] In this instance, no competitive problems were ever proved or any evidence of them adduced in any hearing before a court or administrative agency.[14]

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[12](...continued)
ownership impede the entry of new video programmers or have an adverse affect on diversity. As the Commission found, it was not Congress' intention to require the divestiture of any existing interests. See Sen. Rep. No. 92, 102d Cong., 1st Sess. 34. ("The legislation does not imply that any existing company must be divested".) Based on the record before it, the Commission concluded that divestiture was unnecessary. Second Report and Order at ¶ 27.

[13] Clayton Act, 15 U.S.C. Sec. 16(a).

[14] In fact, the consent agreement, which according to the Chairman of QVC was entered into merely so that TCI's ownership interest would not be a "burden" in the takeover battle for Paramount, clearly states that it is "for settlement purposes only and does not constitute an admission by TCI or Liberty Media Corporation that the law has been violated as alleged in the draft complaint or that the facts as alleged in the draft complaint, other than jurisdictional facts, are true." Telecommunications Inc. and Liberty Media Corp., Agreement Containing Consent Order at 3, File No. 941-0008 (Entered into Nov. 11, 1993).

Thus, the decree would be inadmissible in a court and similarly should be dismissed by the Commission.

In testimony before the Senate Subcommittee on Antitrust, Monopolies and Business Rights, TCI Chairman and CEO John Malone explained the basis upon which TCI entered into the Decree:

> We made the decision to agree to the settlement and divest of our investment in QVC because we did not want to interfere with the process of the tender offer [by QVC for Paramount] and any delay in the approval of the QVC offer for Paramount would have essentially rendered the QVC offer for Paramount moot. [W]e were not admitting that any of these allegations were correct in agreeing to the Consent Decree.[15]

Likewise, the unsupported allegations contained in the private antitrust complaint by Viacom seeking to enjoin QVC from acquiring Paramount, and the related testimony of Viacom's Chairman taken at a Congressional Committee in the heat of the takeover battle, should be accorded no weight. It would be improper, as well as ironic, for the Commission to base its vertical and horizontal ownership limits on allegations that are unproven and clearly motivated by the desire to enhance the speaker's efforts to increase its own ownership concentration in several markets.

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[15] Testimony of John C. Malone before the Senate Subcommittee on Antitrust, Monopolies and Business Rights (December 16, 1993).

B. The Horizontal Ownership Limits May Not Include Telephone Subscribers

CME/CFA's astonishing assertion that telephone subscribers should be included in the cable subscriber limit must be rejected as contrary to the plain language of the 1992 Act. Section 613(f)(1)(A) of the Act requires a reasonable limit on the "number of cable subscribers a person is authorized to reach through cable systems owned by such person ..."[16] Thus, it is clear that Congress directed the Commission to establish limits with respect to cable subscribers and it would violate standard rules of legislative construction to impute to Congress a desire to include telephone subscribers within the limit.[17]

In fact, CME/CFA in its own Petition states that "Congress amended Section 613 of the Communications Act ... to direct the Commission to adopt limits on the numbers of subscribers reached by a cable system."[18] Thus, CME/CFA's own Petition demonstrates that its proposal is inconsistent with the clear language of the law.

III. THE COMMISSION'S 40 PERCENT CHANNEL OCCUPANCY LIMIT IS CONSISTENT WITH ECONOMIC, LEGAL AND PUBLIC POLICY PRECEDENT

Once again, CME/CFA ask the Commission to ignore the benefits of vertical integration and to adopt extraordinarily low

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16 47 U.S.C. § 533(f)(1)(A) (emphasis added).

17 Sutherland Statutory Construction (5th ed. 1992), § 46.01.

18 CME/CFA Petition at 1 (emphasis added).

channel occupancy limits premised solely on the perceived negative effects of such ownership. Yet, the overwhelming evidence in this proceeding demonstrates that vertical integration in the cable industry has produced significant efficiencies in the distribution, marketing, and purchasing of programming which have increased program diversity and quality.[19]

Among the record evidence on the benefits of vertical integration and supporting the Commission's balanced channel occupancy limit is the expert economic analysis prepared by Besen et al., demonstrating the following:

- There is a direct correlation between vertical integration in the cable industry and the substantial program diversity available to consumers. According to Besen, "vertical integration between MSOs and program services can lower costs, leading to reduced prices and increased service quality to the viewing public."[20]
- Vertical integration creates strong incentives for investment in technology. Besen concluded that "limiting vertical integration can increase production costs, leading to reduced quality, and even discourage the introduction of innovations such as digital

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19 Second Report and Order at ¶ 68.

20 Besen et al. at 23.

compression by reducing the returns to innovative activity."[21]

- Foreclosure of a rival program service by a vertically integrated MSO is unlikely to be profitable in most circumstances.[22] Marketplace experience supports the conclusion that vertical integration is not a precondition to carriage of program services. For example, TCI broadly distributes many unaffiliated services, including the following: ESPN (over 92% of subscribers), USA Network (over 91% of subscribers),The Weather Channel (over 88% of subscribers), and Nickelodeon (over 93% of subscribers).

In addition, CME/CFA's principal objections to vertical integration are the possibilities that cable operators would demand equity in a program service in exchange for carriage, or that operators would favor program services in which they have an equity interest over those in which they have no ownership interest. TCI and others have presented marketplace facts showing that such concerns are unfounded.[23] Moreover, the

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[21] Id.

[22] Id. at 37-41.

[23] CME/CFA incorrectly claim that the Commission ignored the evidence presented by the Motion Picture Association of America that a 40% channel occupancy limit could result in situations where no channels are available to unaffiliated programmers. The Commission specifically "disagree[d] with (continued...)

Commission recently adopted, pursuant to Section 616 of the 1992 Cable Act, program carriage regulations specifically designed to prevent such practices.[24] As the Commission has repeatedly pointed out, these regulations address the very concerns underlying the channel occupancy limits and, as a result, eliminate the need for the extreme limits proposed by CME/CFA.

Contrary to the argument advanced by CME/CFA, it does not make economic sense to exclude PEG, leased access, and must-carry channels for channel occupancy purposes. The subject of vertical foreclosure has been addressed by antitrust courts and analyzed by lawyers and economists for decades. We are unaware of any case where it has been deemed appropriate to exclude from the market being examined a particular quantity of output merely because it is produced by a firm other than a vertically integrated firm. The leased access, PEG, and must-carry channels themselves constitute significant channel occupancy limits and

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[23](...continued)
MPAA's assertion that a 40% limit could result in many instances in no channels being made available to unaffiliated video programmers." It concluded that it is "fairly unlikely" that cable systems would drop popular unaffiliated programming services in favor of less popular affiliated services. The Commission is correct. Many services unaffiliated with TCI, such as the Nashville Network, Lifetime, the USA Network, and ESPN, have nearly universal carriage on TCI 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 services in which TCI has an ownership interest.

[24] 47 U.S.C § 536; 47 C.F.R. § 76.1300 et. seq.

clearly dilute the ability of a cable operator to exercise market power over all channels on its system. Therefore, such channels are properly included in the universe of channels for determining channel occupancy limits.

A. The Commission's Decision to Apply Channel Occupancy Limits Only to the First Seventy-Five Channels Is Consistent with Congress' Goals and Will Promote the Advancement of New Technology

In its previous Comments, 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 channel occupancy limits 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. TCI pointed out that the constant fluctuations in useable system capacity inherent in a digitally compressed environment necessitate the use of this more objectively precise and adaptive system bandwidth measurement.[25]

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[25] See TCI Comments at 38-50; TCI Reply Comments at 16-17.

The Commission's Second Report and Order properly recognized that emerging technologies will reduce the need for channel occupancy limits. Accordingly, the Commission decided to apply the channel occupancy limit only up to 75 channels on a cable system owned by a vertically integrated MSO and to exempt additional channel capacity made possible through advanced cable technologies.[26] TCI believes that the Commission's channel capacity threshold of 75 channels is a positive interim solution.

CME/CFA oppose the Commission's decision to apply channel occupancy limits only to the first 75 channels, arguing that "consumers will not see increased diversity of sources unless channel occupancy limits are applied to all channels."[27] However, the Commission correctly observed that expanded channel capacity resulting from the deployment of fiber optic cable and digital compression obviates the need for channel occupancy limits as a means of encouraging cable operators to carry unaffiliated video programming. Significantly increased channel capacity will result in greater program diversity and expanded consumer choice because cable operators have the incentive to maximize the use of system capacity by seeking out innovative programming services. Channel occupancy limits under these circumstances are simply unnecessary.

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[26] Second Report and Order, at ¶¶ 83-84. The channel occupancy limits need not necessarily apply to the first 75 channels. Id. at n. 107.

[27] CME/CFA Petition at 20.

Moreover, as demonstrated by the Besen economic analysis, channel occupancy limits, because they reduce the ability of a firm to achieve returns on its investment, can lead to decreased investment in new technology.[28] The CME/CFA position is therefore inconsistent with the National Information Infrastructure goals of Congress, the Commission and the Administration.

B. Grandfathering Existing Carriage Relationship from the Channel Occupancy Limits Serves the Public Interest

CME/CFA urge the Commission to reverse its decision to grandfather all vertically integrated programming services that were carried as of December 1992 on the grounds that the Commission did not know how many systems were in compliance with the new rules.[29] Their argument, however, misses the point. As the Commission found, "the public interest would be disserved by requiring cable operators to delete vertically integrated video programming services in order to comply with the channel occupancy caps."[30] Thus, grandfathering existing vertical relationships is in the public interest regardless of how many systems are in compliance with the new rules. By grandfathering existing carriage relationships, the Commission minimized the disruption to existing programming relationships and prevented

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[28] Besen et al. at 23-24.

[29] CME/CFA Petition at 21.

[30] Second Report and Order at 93 (emphasis added).

consumer unhappiness and confusion that would be caused by the loss of services consumers had grown accustomed to receiving.

C. The Commission Should Not Eliminate the Single Majority Shareholder Exception From the Attribution Rules Applied to the Subscriber and Channel Occupancy Limits

CME/CFA object to the single majority shareholder exception of the Commission's attribution rules, arguing that the TCI and Time Warner minority interests in Turner Broadcasting confer a "substantial voice" in the operation of the Turner program services.[31] Thus, CME/CFA's argument rests on equating influence with control. But the Commission historically has not equated influence with control:

> [I]nfluence and control are not the same. The influence must be to the degree that a minority shareholder is able to '<u>determine</u>' the licensee's policies and operation, or <u>dominate</u> corporate affairs.[32]

Commission policy rejects the notion that influence alone is sufficient to render a minority shareholder's interest cognizable under the attribution rules. The issue is not whether a minority owner has a "substantial voice," but whether it dominates the programmer's affairs.[33]

TCI's and Time Warner's exercise of voting rights to block investments by Turner Broadcasting is perfectly consistent with

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[31] CME/CFA Petition at 23.

[32] <u>News International, plc,</u> 97 FCC 2d 349, 356 (1984) (emphasis added).

[33] <u>Id</u>. at 362.

the single majority shareholder exception. The Commission has found that these types of activities do not constitute impermissible control.[34] Negative covenants, like those allowing minority shareholders to block major transactions, do not constitute de facto control.[35] Super-majority approval of certain transactions is also permissible under the Commission's broadcast attribution rules.[36] The issue is not whether TCI or Time Warner can block certain actions by Turner Broadcasting but whether TCI or Time Warner dominate Turner Broadcasting's corporate affairs. CME/CFA have not even alleged, let alone proved that TCI or Time Warner have such power.

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[34] In re Application of National Broadcasting Co., Inc., and Multimedia, Inc. For Consent to the Transfer of Control of the Licensee of Television Station WKYC-TV, Cleveland, Ohio, 6 FCC Rcd 4882 (1991).

[35] News International, plc, supra at 358; Data Transmission Co., 44 FCC 2d 935, 936-937 (1974).

[36] News International, plc, supra at 361-362.

IV. CONCLUSION

For these reasons, TCI urges the Commission not to adopt the extreme proposals advanced by CME/CFA in this proceeding, but rather to adhere to its earlier, balanced approach to these issues.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing "Opposition of Tele-Communications, Inc." was served by First Class mail, postage prepaid, this 14th day of February, 1994, upon:

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AN ECONOMIC ANALYSIS OF THE FCC'S PROPOSED CABLE OWNERSHIP RESTRICTIONS

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CHARLES RIVER ASSOCIATES INCORPORATED

February 9, 1993

I. Introduction

The Commission's Notice of Proposed Rule Making and Notice of Inquiry on Horizontal and Vertical Ownership Limitations and Anti-trafficking Provisions solicits comment on three basic issues: (1) the nature of the limits to be placed on the number of cable subscribers that can be served by commonly-owned cable systems ("subscriber limits"); (2) the nature of the limits to be placed on the number of channels on a cable system that can be occupied by program services in which the operator has an ownership interest ("channel occupancy limits"); and (3) whether limits should be placed on the ability of cable systems to engage in video program production. The Commission also seeks comments on the implementation of the anti-trafficking provisions of the Cable Act of 1992. This paper provides an economic analysis of each of these issues.

The first section addresses the effect of the existence of large Multiple System Operators (MSOs) on their ability to exercise market power in their dealings with subscribers, advertisers, and cable program services. We begin by describing the efficiencies that result when there are large MSOs. These include efficiencies both in program acquisition and in planning and developing new technologies and services.

Next, we analyze the concerns that larger MSOs might be able to exercise increased market power in dealings with subscribers and local advertisers. We conclude that there is little basis for such concern because commonly-owned cable systems rarely compete as sellers. We also conclude, for the same reasons, that increased concentration in cable system ownership does not raise the risk that cable operators would collude, overtly or tacitly, as sellers.

We next analyze the possibility that multiple system operators serving more subscribers might exercise market power in their dealings with program services. Although this possibility cannot be dismissed as easily as can the threat that market power might be exercised against subscribers and advertisers, we conclude that there is very little risk that the exercise of monopsony power poses a threat to the diversity and quantity of programming available to consumers. The nature of bargaining between large MSOs and cable program services permits prices to be raised for some services without increasing the prices that are paid for others. As a result, even if large MSOs can affect the prices they pay for programming, they will have no incentives to restrict their purchases of cable program services. For all these reasons, we favor relatively high limits on the number of cable subscribers that can be served by commonly-owned cable systems. We conclude that neither the current level of horizontal concentration in cable ownership, nor an increase in that concentration, pose a substantial threat of increased market power and reduced program diversity.

Our analysis of the issues involving vertical integration, which are raised by the channel occupancy limits, is more complex.

We begin our analysis by describing the efficiencies that may flow from vertical integration between cable systems and cable program services. These efficiencies clearly must be balanced against any anticompetitive concerns.

We cannot dismiss, as theoretical matter, the possibility that a cable program service that is vertically integrated with a cable operator might be able to use that relationship to disadvantage a rival service. In the context of the cable television industry, however, the set of factual circumstances in which such behavior would be profitable are sufficiently stringent that we cannot regard this as an imminent threat. This is so for several reasons. The cable operator may be unable to damage the rival service because the operator is too small, because the rival service is profitable enough to withstand the loss of revenue, or because the rival service can protect itself by lowering payments to programming inputs. Foreclosure, even if it could harm the rival service, may yield little or no payoff because the affiliated program service faces too many other substitutes. The costs incurred by the cable operator incurred to disadvantage the rival service may be greater than the gains of the affiliated program service. The ownership of many program services is dispersed, raising the prospect that the foreclosing cable operator must share the gains with other owners of the service who do not bear the associated costs. Finally, rival program services may have means of protecting themselves from harm -- what economists call counterstrategies -- that prevent a foreclosure strategy from