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March 28, 1994

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Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, NW, Room 222
Washington, DC 20554

Re: Notification of Permitted Ex Parte Presentation
MM Docket No. 92-265

Dear Mr. Caton:

In accordance with Section 1.1206(a)(1) of the Commission's rules, please find enclosed for inclusion in the public record of the above-captioned proceeding two copies of a written ex parte presentation made this date by the undersigned on behalf of our client Viacom International Inc. to the following Commission officials:

James W. Olson
Chief, Competition Division
Cable Services Bureau

Diane L. Hofbauer
Director, Program Access
Cable Services Bureau

Amy Zoslov
Cable Services Bureau

Meryl Icove
Cable Services Bureau

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Kindly direct any questions regarding this matter to the undersigned.

Respectfully submitted,

Wayne D. Johnsen

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WDJ/rg
Enclosures
cc: James W. Olson
Diane L. Hofbauer
Amy Zoslov
Meryl Icove

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March 28, 1994

James Olson, Chief
Competition Division
Cable Services Bureau
Room 918
2033 M Street, N.W.
Washington, D.C. 20554

Dear Jim:

I am writing to confirm that the Viacom executives participating in our meeting on Wednesday, March 30 will be as follows:

Tony Cox	--	Chairman, Chief Executive Officer, Showtime Networks Inc.
Mark Weinstein	--	Senior Vice President, Government Affairs, Viacom International Inc.
Gwen Marcus	--	Senior Vice President, General Counsel, Showtime Networks Inc.

We plan to discuss two particular aspects of the program access proceeding: (1) exclusive agreements between programmers and non-cable distributors and (2) a proposed exemption from program access regulation where fewer than 5 percent of a network's subscribers are on commonly-owned cable systems.

Viacom believes that the Commission was entirely correct when it determined in the First Report and Order that exclusive agreements with non-cable distributors are permissible. Our position with respect to this issue can be briefly summarized as follows:

- The Supreme Court long ago recognized that exclusive dealing arrangements can be procompetitive.

- Viacom's agreements with USSB illustrate the procompetitive potential of non-cable exclusivity. Because of superior transponder capacity, DirecTV has a 5-1 advantage over USSB in the number of program services that can be offered to consumers (*i.e.*, 150 vs. 30 channels for USSB). This advantage will give DirecTV (and, as we understand it, DirecTV's exclusive agent for rural areas, the NRTC) *de facto* exclusivity with respect to numerous services -- regardless of the outcome of the current reconsideration petitions. To be viable as a competitor, USSB needed to differentiate its program offerings from those available over DirecTV.

- The Viacom/USSB agreement demonstrates that non-cable exclusivity will foster greater program diversity. The existence of exclusive distribution agreements in DBS will serve to maximize the diversity of programming presented over the 180 channels offered by DirecTV and USSB by reducing unnecessary duplication of program offerings and wasteful use of limited DBS transponder capacity by these two transmission systems. Further, DirecTV and USSB will utilize the same receiver equipment to permit subscription to both systems where consumers so desire. Such subscriptions to multiple distribution systems are already common in the TVRO business and could enable DBS consumers to receive essentially all satellite-delivered programming now available to cable subscribers.

- The 1992 Cable Act preserves the opportunity for non-cable distributors to enter into exclusive agreements. As reflected in the Conference Report, the Act's prohibition on exclusivity applies specifically to "arrangements between a *cable operator* and a . . . vendor." The Act did not purport to regulate agreements involving non-cable operators which quite obviously lack the market power to extract anticompetitive concessions from programmers. Indeed, as noted above, Viacom's exclusive arrangements with USSB will help prevent the emergence of a DBS monopolist with similar market power over programmers and consumers.

In its initial comments in this proceeding, Viacom also urged the Commission to adopt a de minimus exemption from the program access rules for any program service whose commonly-owned cable systems represented a very small percentage of its total subscribership. Viacom pointed out that such program services have neither the incentive nor the ability to discriminate against alternative technology distributors. Although the Commission initially declined to adopt such an exemption "because the record [did] not provide sufficient data to support a definitive point at which incentives for such vendors to favor their affiliated customers differ from other vertically integrated programming vendors," it stated that it would be willing to revisit the matter if such data were to be provided.

In its petition for reconsideration, Viacom has further addressed this issue by supplying an economic study prepared by Robert Crandall, a Senior Fellow of the Brookings Institution, and Michael Glassman, the President of Glassman-Oliver Economic Consultants, Inc. Their findings may be briefly summarized as follows:

- To realize a net economic gain from a policy of anticompetitive price discrimination, a vertically integrated firm must have substantial cable system holdings. The Act assumes that vertically integrated firms with significant cable and programming interests might have an economic incentive to favor cable operators over their competitors. This discriminatory behavior would be designed to induce consumers to shift their subscriptions from alternative distribution systems to cable systems. Such a strategy would make economic sense only if the programmer had a sufficiently high level of ownership of cable systems so that the lost profits on the programming side (resulting from decreased subscription and/or viewership levels) would somehow be overcome by increased profits on the cable distribution side.

- <u>Several other factors combine to sharply limit the circumstances in which anticompetitive discrimination might be profitable</u>.

  - The ability of a vertically integrated programmer to switch subscribers from an alternative distribution system to its own cable systems is dependent upon the degree of geographical overlap in service areas between the two competing distribution systems.

  - In some instances (<u>e.g.</u>, SMATV or MMDS systems that serve urban apartment buildings where access is controlled by the building owner), consumers would not have a practical ability to switch to cable.

  - Depriving an alternative distribution system of a vertically integrated programmer's service (or causing a modest price increase) would likely cause subscribers to simply switch their viewing to a competing programmer -- not to entirely change distribution systems.

- <u>If the commonly owned cable systems of a vertically integrated program service accounted for fewer than 5 percent of the program service's subscriber base, there is no scenario in which discrimination against alternative distributors that compete nationwide could be profitable</u>.

  - Even if the network could shift <u>all</u> of its non-cable subscribers to cable -- obviously an extreme assumption -- the vertically integrated program service would have to control systems with more than 13 percent of all the country's cable households for the strategy to be economically advantageous.

  - Since this number is far above the 5 percent <u>de minimus</u> threshold suggested by Viacom, the Commission can feel <u>very</u> comfortable with the cut-off that has been proposed.

- <u>Failure to establish a de minimus exemption could have negative public interest consequences</u>.

  - It would impose significant unnecessary costs on programmers that find themselves squeezed between program suppliers on the one hand and cable operators on the other.

  - To the extent that these costs are substantial, they would create incentives for these programmers to divest their commonly owned cable systems (which could have negative consequences as described below).

  - The most likely purchasers of such systems are the larger MSOs which are in a more advantageous position (on a per-subscriber basis) to absorb the new regulatory costs.

  - Such sales could thus significantly increase horizontal concentration in the cable industry.

  - Failure to adopt a <u>de minimus</u> exemption would create further barriers for entry into the programming business (or expansion of such services) by smaller MSOs.

* * *

We look forward to meeting with you on Wednesday to discuss these matters further.

Best regards.

Sincerely yours,

Lawrence W. Secrest, III

Lawrence W. Secrest, III WDJ

LWS:lmb