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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

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In the Matter of	)	
	)	
Implementation of Section 19 of the Cable Television Consumer Protection and Competition Act of 1992	)	CS Docket No. 94-48
	)	
Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming	)	

COMMENTS OF
THE NATIONAL CABLE TELEVISION ASSOCIATION, INC.

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THE NATIONAL CABLE TELEVISION ASSOCIATION, INC.

The National Cable Television Association, Inc., ("NCTA"), by its attorneys, hereby submits its comments in response to the Notice of Inquiry ("NOI") on the status of competition in the market for the delivery of video programming. NCTA is the principal trade association of the cable television industry in the United States, representing the owners and operators of cable television systems serving over 80 percent of the nation's 59 million cable households. NCTA's members also include cable programmers, equipment suppliers and others affiliated with the cable industry.

INTRODUCTION AND SUMMARY

In this wide-ranging inquiry, the Commission seeks information on the status of competition in the multichannel video programming market pursuant to the annual reporting requirement in the 1992 Cable Act, 47 U.S.C. § 548. In conjunction with its analysis of the extent and growth of effective competition to cable, the Commission has set three goals: (1) to gather enough information to prepare a preliminary report to Congress on the current state of competition to cable; (2) to collect information on whether and the extent to which the conduct and practices of multichannel video programming vendors and distributors have changed; and (3) to identify the information required to enable the Commission to prepare more comprehensive analyses in its future reports and the appropriate methods of obtaining such information.[1]

The Commission's starting point is its comprehensive 1990 report to Congress on the state of the cable television industry.[2] In that report, the Commission found, inter alia, that "robust competition in the video marketplace has not yet fully evolved, but that the development of a fully competitive marketplace is possible."[3] Citing the "developing field of existing and potential multichannel competitors to cable" and "evidence that even direct competition between cable operators" is on the rise, the

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1 NOI at para. 8.

2 Competition, Rate Deregulation and the Commission's Policies Relating to the Provision of Cable Television Service, MM Docket No. 89-600, 5 FCC Rcd 4962 (1990) ("1990 Cable Report"), at para. 9.

3 Id.

Commission's "overall analysis" was that "the video marketplace is a highly dynamic sector in a state of transition."[4]

Over the last four years, as the Commission predicted, the video marketplace has evolved into an even more volatile and competitive environment. Spurred by technological advancements and governmental actions, the video marketplace is now teeming with new players and highly charged incumbants eager to participate in the new digital information age. The influx of innovative new cable networks anticipating the 500-channel world and the hastening of joint venture activity is further evidence of heightened competition in the video marketplace.

Alternative video technologies, such as multichannel multipoint distribution systems ("MMDS") and satellite master antenna television ("SMATV") are achieving new clout in many communities. The long-awaited and much-touted direct broadcast satellite ("DBS") service is no longer a mere promise -- it has arrived with the recent launch of high-powered DBS satellites. Broadcast television is stronger than ever, armed with increased advertising revenue, retransmission consent rights, must carry and channel position protection and the demise of most of the broadcast financial interest and syndication rules. Broadcasters too may offer multiple channels of video programming within their existing spectrum. Even the electric utilities are looking to become video providers in the near future.

Perhaps most compelling is that the telephone industry -- the behemoth of the telecommunications marketplace by any measure -- has escalated its efforts in the past six months to establish video dialtone

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4 Id.

platforms in market after market around the country. As local telephone companies enter the video marketplace, precautions should be taken to ensure that their size and financial strength does not stand in the way of facilities-based competition in a variety of telecommunications and information services.

Indeed, as competition emerges in the marketplace, Congress is moving toward enacting sweeping legislation this year that will speed the development of an advanced, competitive telecommunications infrastructure in the United States. H.R. 3636, the "National Communications Competition and Information Infrastructure Act of 1994", is aimed at "encouraging the deployment of advanced communications technologies to benefit all Americans by injecting competition into the market for local telephone service and video programming, . . ."[5] The cable television industry supports legislative efforts to promote a competitive marketplace that will allow consumers to choose between alternative providers of advanced voice, video and data services. But as long as the telephone companies retain their dominant position in the local exchange marketplace, their entry into the television business should be subject to structural and regulatory safeguards that will ensure fair competition in the video market.

In the midst of this massive transition, the cable television industry is implementing FCC-imposed rate regulation rules and policies until effective competition, as defined by the 1992 Cable Act, develops. Unfortunately, the Commission has based its rate-setting methodology for the entire industry on survey data of "overbuild" systems in franchise areas serving

5 H.R. Rep. No. 103-560, 103d Cong., 2d Sess., 4 (1994). See also S. 1822, the "Communications Act of 1994".

fewer than 5,000 subscribers. These small system franchises, which are not representative of the industry, differ substantially from large cable systems in such areas as per-subscriber revenue requirements, operating expenses, and market environments. As demonstrated in an Arthur D. Little study appended to these comments, when cable system size is taken into account in calculating the competitive price differential between competitive and non-competitive cable systems, the Commission's 17 percent "competitive differential" is reduced to almost zero.

Moreover, the evidence shows that in larger cable markets (those serving more than 5,000 subscribers), the presence of multiple over-the-air broadcast signals exerts downward pressure on cable rates. Thus, the Commission should urge Congress to reconsider its definition of "effective competition" in light of the competitive effect of over-the-air broadcasting on cable behavior.

In addition to rate regulation, the 1992 Cable Act imposed structural and behavioral limitations on cable and adopted provisions that are designed to boost the competitive status of cable's competitors -- notably access to cable programming services. The FCC also has intervened with various regulatory measures to assist alternative multichannel video distributors gain a larger stake in the video marketplace-- distributors who face none of the federal and local regulations on their businesses that are borne by cable operators. Accordingly, cable's competitors have the statutory and regulatory tools in place to position themselves as serious contenders in the video marketplace.

As we demonstrate below, the multichannel competitive environment that Congress envisioned is emerging. Now more than ever cable television is facing competition, both wired and wireless, at both the national and local level. Meanwhile, horizontal concentration and vertical integration in the cable industry has remained virtually unchanged since 1990.

I. COMPETITION FROM ALTERNATIVE VIDEO DELIVERY MEDIA AND COMPETITION IN THE DELIVERY OF VIDEO PROGRAMMING

A. TELEPHONE COMPANIES

Over the past six months, the Regional Bell Operating Companies and several independent telephone companies have announced aggressive plans to enter the cable television business as video dialtone providers in their service areas. The RBOCs also are seeking entry by challenging the cable/telephone cross-ownership restriction on First Amendment grounds in the federal courts. Bell Atlantic and U S West have succeeded in overturning the ban as it applies to them in their respective regions.[6]

On June 16, 1994, Bell Atlantic filed applications for regulatory approval to construct video dialtone facilities in six metropolitan areas, including Baltimore, Philadelphia, Northern New Jersey and Pittsburgh.[7] Bell Atlantic previously announced plans to begin serving certain Washington area neighborhoods with cable television and "video-on-demand" services by the end of 1994. [8] Other neighborhoods are targeted

6 Chesapeake and Potomac Telephone Company of Virginia v. United States, 830 F.Supp. 909 (E.D. Va. 1993), appeal held in abeyance Nos. 93-2340, 93-2341 (4th Cir. June 15, 1994); U. S. WEST, Inc. v. United States, No. C93-1523 (W.D. Wash. filed June 14, 1994).

7 "Bell maps out video network, with one big hole", Philadelphia Inquirer, June 17, 1994; "Bell Atlantic Corp. Scales Back Plans For Data Highway", Wall Street Journal, June 17, 1994.

8 "Bell Unveils Plan For Local Cable, Video Service", The Washington Post, June 16, 1994, at B13.

for service within the next three years. This is part of an all-out program by Bell Atlantic to deploy multimedia, interactive services, movies on demand and a variety of both packaged and "a la carte" channels to subscribers throughout the mid-Atlantic region by the year 2000.[9] The company projects it will serve 8.5 million homes at a cost of $15 billion.

Pacific Telesis Group announced a comprehensive $16 billion, seven-year roll-out of a new broadband voice and video system in its region. Initially, PacTel intends to upgrade its network to serve 1.5 million subscribers in California's most densely populated areas by 1996 and has targeted about 5 million subscribers by the year 2000.[10] U.S. West has "a long term plan for construction of a $13 billion broadband net in its 14-state service area."[11] Similarly, Ameritech has a "15-year 'grand plan' to create a broadband network serving all major customer clusters in the RBOC's five-state territory (Illinois, Ohio, Michigan, Indiana, Wisconsin)."[12] Ameritech's proposed plan is looking to reach 6 million homes and businesses in the next several years with 300 channels, including 240 digitally compressed channels.

Nynex announced this week that it will seek FCC authority to wire the Boston area for interactive services by the end of 1994 and plans to deploy video dialtone platforms for another one million customers in New

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9 Id.; "Interactive Video by '95", Philadelphia Daily News, May 20, 1994.

10 "The Dawn of Competition", Cablevision, May 25, 1994 at 70 ("Dawn of Competition").

11 Id.

12 Id.

York City by the end of 1996.[13] According to the Nynex Vice President for entertainment and information services, "[t]his isn't blue sky. . . .[t]his marks the beginning of our entry into the video world."[14] Bell South and Southwestern Bell also are planning to compete in the cable television business in the near future, the latter already a significant operator out of its service territory.

The independent telephone companies have not been left out of the loop. GTE is looking to serve 7 million of its subscribers with its broadband networks; Southern New England Telephone is rolling out a 100-channel video-on-demand test system now and awaiting FCC approval to extend to 20,000 homes in West Hartford, Connecticut.[15] Rochester Telephone is planning to test a video-on-demand system in Rochester, New York.[16]

For each of these companies, construction of new broadband facilities has already begun or is awaiting FCC approval, with fiber upgrades and testing already underway in many locales around the country. As demonstrated in Attachment A, there are now 28 Section 214 video dialtone applications currently filed with the FCC, of which 5 have been granted and 23 are still pending. Taken together, these applications total a projected

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13 "Nynex Plans to Request FCC Clearance For Interactive Network in Boston Area", The Wall Street Journal, June 27, 1994, at B8; "Multimedia Chess: The Players Line Up", Cable World, November 15, 1993, at 1.

14 Id.

15 "Dawn of Competition" at 80; "GTE to Roll Out Video-Phone Link in Northern Va.", The Washington Post, May 25, 1994, at F1.

16 "Dawn of Competition" at 80.

subscriber base of almost 8 million homes, or 8.8 percent of the 91.6 million homes with telephones.[17]

While video dialtone offers the potential for increased competition in the video marketplace, NCTA has expressed concern that the Commission's video dialtone policy and practice remains ad hoc, with standards for evaluating applications still unwritten.[18] Before the Commission authorizes commercial video dialtone service, it should more fully define the service and the roles of the telephone company and customer-programmers. And it should adopt more detailed safeguards to ensure that telephone companies do not enter the marketplace via improper cross-subsidization or other anticompetitive means. Without such rules, the Commission's desire to promote competition could be seriously undermined.

B. MMDS

Wireless technology is experiencing dramatic new interest and investment growth. Over the last year, MMDS subscribership has increased from 393,000 to 593,000, and is projected to reach 869,000 by the first quarter of 1995.[19] According to the Wireless Cable Association, by the end of this year, wireless cable systems will be operating or ready to operate in 23 of Arbitron's top 25 television markets, and in a variety of medium to small markets as well.[20] This represents access to nearly half the country's

[17] Video Dialtone Applications Status List, FCC Common Carrier Bureau, June 27, 1994 (unofficial document).

[18] See, e.g., Consumer Federation of America/National Cable Television Association, Inc. Joint Petition for Rulemaking, RM-8221, April. 8, 1993.

[19] Paul Kagan Associates, Inc., Marketing New Media, April 18, 1974, at 4.

[20] "Dawn of Competition" at 70; Paul Kagan Associates, Inc., Wireless Cable Investor, February 28, 1994, at 4.

92.8 million television homes. Within the next five to six years, one industry consultant estimated, "the wireless cable industry will be serving more than 4 million subscribers and generating approximately $2 billion in annual revenues."[21]

Wireless cable's growth is attributable to a variety of factors. As the NOI points out, a variety of regulatory measures have increased the channel capacity and service area reach of MMDS systems.[22] The new program access rules, which closely regulate the programming distribution practices of vertically-integrated cable companies, provide multichannel distributors unprecedented access to cable services under non-discriminatory terms and conditions.[23] Moreover, the new home wiring rules give alternative providers access to cable wiring inside a subscriber's premises upon termination of service in order to enable such providers to connect the wiring to their systems without having to re-wire the home.

Investor confidence in the industry has generated new capital for construction and acquisitions. Indeed, six months ago there were four publicly traded wireless stocks; today there are nine, with more likely to follow over the next few months.[24] With low overall capital requirements

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21 "Dawn of Competition" at 88.

22 NOI at ¶¶ 20-22; "FCC moves to strengthen wireless cable", Broadcasting: & Cable, June 13, 1994, at 11.

23 Indeed, a guide published by the law firm of Sinderbrand & Alexander, counsel to the Wireless Cable Association, pleaded with wireless operators not to "act like pigs feeding at the trough" with their new program access rights, but to wait until the rules were released. Paul Kagan Associates, Inc., Wireless Investor, May 13, 1993, at 3.

24 "Dawn of Competition" at 88. According to the Wireless Cable Association, between December 1992, when ACS Enterprises Inc. raised $10 million in the first wireless public offering, and March 1994, the wireless cable industry raised $440 million

and few regulatory burdens, wireless operators can position themselves as strong competitors to cable in pricing their product to consumers.[25]

In Tucson, Arizona, for example, the People's Choice wireless system has achieved 10 percent penetration in less than 3 years.[26] In New York, wireless competitors, overbuilders, telephone and SMATV operators are hoping to penetrate 30 to 40 percent of cable's 1.8 million area households.[27] And, as the NOI notes, FCC authorization of a new wireless service in the 28 GHz band is pending approval, the so-called Local Multipoint Distribution Service ("LMDS"). Several major investors, including Bell Atlantic, and Philips Electronics North America Corp., are backing the CellularVision LMDS system which is offering a package of programming services in Brooklyn, New York.[28]

As the president of Liberty Cable, a SMATV operator in New York City, asserts, "most people concede today that major markets will be a hotbed of competition . . . the question is not whether they will be competitive, but how serious the competition will be."[29]

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through public equity sales. "Wireless Industry Still Seeks Respect", Multichannel News, June 6, 1994.

25 According to Paul Kagan Associates, the average monthly rate for wireless cable service is $26.50. Wireless Cable Investor, April 25, 1994 at 2.

26 "Wireless Industry Still Seeks Respect", Multichannel News, June 6, 1994.

27 "Cable Faces Foes in NYC, Conn.", Cable World, April 25, 1994, at 11.

28 "Dawn of Competition" at 90.

29 "Cable Faces Foes in NYC, Conn.", Cable World, April 25, 1994 at 11.

C. DIRECT BROADCAST SATELLITE AND HOME SATELLITE DISHES

DBS is finally becoming a reality. Backed by major well-financed companies, there are now three direct broadcast satellite services up and ready to offer digitally compressed signals of near video on demand and multiplexed pay and basic services to virtually every home in the United States.[30] DirecTV, which is owned by General Motors' subsidiary, Hughes Electronics Corporation, represents a $600 million investment in the multichannel video marketplace. The service intends to launch in five markets over the next several months, including Tulsa, Oklahoma, Little Rock, Arkansas, and Albuquerque, New Mexico, and it will initiate a national marketing effort in the fall.[31] Retailers are aggressively marketing the small dishes and related product to consumers.[32]

DirecTV has locked up agreements with all of the major cable programming suppliers, including such networks as CNN, the Discovery Channel, the Disney Channel, ESPN, TNT, USA Network, C-SPAN, and CNBC.[33] The company is on the verge of finalizing a deal to bring Sunday night NFL football games to its subscribers next season.[34] DirecTV and

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[30] "Dawn of Competition" at 82; "Cable TV gets competition via satellite", Boston Globe, May 26, 1994; "Dishing up full-power DBS", Broadcasting and Cable, March 28, 1994, at 48; "The Little Dish that Could . . .Direct-broadcast TV gets ready to beam in on cable's turf", Business Week, April 4, 1994.; "Opening new channels with smaller satellite dishes", USA Today, April 8, 1994.

[31] "Dishing up full-power DBS," Broadcasting & Cable, March 28, 1994, at 50.

[32] "June 17: The DBS era begins", Broadcasting & Cable, June 20, 1994, at 41.; "New DBS deadline: June 23", Broadcasting & Cable, June 6, 1994, at 57.

[33] "Dawn of Competition" at 84.

[34] "June 17: The DBS era begins", Broadcasting & Cable, June 20, 1994 at 40.

Hubbard Broadcasting's U.S. Satellite Broadcasting DBS service expect to deliver a combined total of over 300 channels of movies, sports, and satellite services. DirecTV projects "having 10 million subs by the end of the century."[35]

Stanley Hubbard, president-CEO of U.S. Satellite Broadcasting told the NAB convention in April that with DBS "cable will finally get competition" and that he expects the technology to substantially "cut into cable penetration".[36] USSB has carriage agreements with major cable programming networks, including multiplexed feeds of HBO and Showtime. Hubbard predicts that DBS will reach 50 million homes in 10 years.

Primestar Partners, another DBS operator, already serves 70,000 customers and has targeted 300,000 to 400,00 subscribers by the end of 1994.[37]

The existing C-band home satellite dish industry remains strong with over 390,000 dishes shipped in 1993, up from 364,000 units in 1992.[38] In total, the Satellite Broadcasting and Communications Association (SBCA) estimates that over 4.3 million home satellite systems have been shipped in the U.S.[39] The recent $350 million debt offering filed by Echosphere

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[35] "Dawn of Competition" at 84.

[36] "Trouble Ahead? DBS will make major problems for cable, USSB's Hubbard promises", Cable World, March 28, 1994, at 10.

[37] "Firms race to serve up dish of entertainment", The Philadelphia Inquirer, April 11, 1994.

[38] Satellite Broadcasting and Communications Association (SBCA), Satellite TV, 1994.

[39] Id.

Corporation, a major home satellite dish (HSD), distributor is evidence of the ongoing strength of the dish industry.[40]

According to SBCA, HSD subscribers have access to 103 subscription services and over 75 unscrambled satellite services.[41] And the variety of packages available via local retailers and direct sale 800 numbers has grown dramatically in recent years. Moreover, HSD packages continue to be available at prices equivalent to or lower than the prices charged to cable subscribers.[42]

D. CABLE OVERBUILDS

As described in the NOI, in adopting rate regulation rules and policies, the Commission conducted a "Competitive Survey" of cable systems in 1992 to determine the competitive differential between competitive and non-competitive systems. The survey included "overbuilds", i.e. systems which compete head-to-head with at least one other multichannel video provider. The Commission initially determined in its benchmark formula that, on average, systems subject to effective competition charge rates ten percent lower than the rates of systems not subject to effective competition.[43] On reconsideration, it concluded that the

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[40] "Dishing up full-power DBS", Broadcasting & Cable, March 28, 1994 at 48.

[41] SBCA, Satellite TV.

[42] For example, All Networks, a third party packager, offers HSD subscribers a 22-channel "Basic Plus" package for $17.25 per month. Similarly, Turner Vision's (not affiliated with Turner Broadcasting) "Best of the Best" package contains 36 channels (including TNT, Nickelodeon, USA Network) for $22.95 per month. See Satellite Orbit, May 1994.

[43] Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992, Rate Regulation, Report and Order and Further Notice of Proposed Rulemaking, MM Docket 92-266, 8 FCC Rcd 5631, 5644-45.

competitive price differential is actually 17 percent for all systems, and directed operators to adjust their rates accordingly. We show, however, that the Commission's rate-setting methodology, as demonstrated in the attached report by Arthur D. Little Inc.,[44] is based on invalid assumptions.

In performing statistical analyses on the Commission's cable franchise survey data, A.D. Little found that the estimated price differential is derived solely from small system franchises, i.e. operators serving fewer than 5,000 subscribers, which are not representative of the cable industry. Moreover, although small and large cable systems share comparable per subscriber capital investments, small systems typically have lower per-subscriber revenue requirements, lower operating expenses and are located in market environments that are very different from large system markets. Additionally, many of the small system franchises in the FCC's competitive sample are not commercially viable or have financial structures that are atypical of the cable industry.

Despite the vastly different attributes of small and large cable systems, the Commission inappropriately relied on the small-system sampling in setting rates for the entire industry. When cable system size is taken into account in calculating the competitive price differential, A.D. Little demonstrates that the differential is reduced to almost zero. This confirms the findings in the study conducted by Economists Inc. last year -- that for systems with more than 5,000 subscribers, there are no statistically

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[44] Arthur D. Little, Inc., Evaluation of FCC Methodology for 1994 Rate Order, June 1994.

significant differences between the rates charged by systems that face effective competition and the rates charged by systems that do not.[45]

Similarly, in their examination of the FCC's methodology and data employed in the benchmark scheme, James N. Dertouzos and Steven S. Wildman concluded that the Commission overestimated the impact of overbuild competition on cable system rates.[46] They concluded that "there is strong reason to believe that overbuild systems differ systematically from other systems in ways that are not accounted for in the FCC approach. For example, overbuild franchises differ in size, in location, in revenue sources, and the likelihood of competition from six over-the-air television stations."[47] The analysts suggested that "the likely effect of not allowing for these differences is not only to greatly overestimate the effect of overbuild competition but also to introduce significant biases that would likely disadvantage certain segments of the cable industry, i.e., larger systems, franchises located in high-cost regions, and those with fewer tiers of services." [48] All of these factors, insufficiently weighed by the Commission, relate to the cost of providing cable television services.

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45 See Economists Incorporated, The Effect of "Competition" on Rates for Large and Small Cable Systems, 1993 (attached to NCTA Petition for Reconsideration, Rate Regulation, MM Docket No. 92-266, filed June 21, 1993).

46 See James N. Dertouzos and Steven S. Wildman, Regulatory Benchmarks for Cable Rates: A Review of FCC Methodology ("Regulatory Benchmarks") (attached to Petition for Reconsideration of Viacom, Inc., Rate Regulation, MM Docket No. 92-266, filed June 21, 1993).

47 Id.

48 Id.

Therefore, the Commission's 1992 Competitive Survey is an invalid baseline measure of the effect of competition from cable system overbuilds.

E. OVER-THE-AIR BROADCAST TELEVISION

Although Congress and the Commission have concluded that over-the-air broadcasting, by itself, is not an "effective competitor" to multichannel cable television, NCTA has consistently shown that broadcast signals alone can and do effectively constrain the price of cable service.[49] In their recent study on the Commission's benchmark methodology, Dertouzos and Wildman concluded that over-the-air television appears to have a competitive effect that is similar to the effect of overbuild competition:

> For the three measures of cable pricing, number of subscribers, and number of channels on a system, changes due to the presence of six over-the-air (OTA) signals is about the same as the response to direct overbuild competition. In addition, our study provides estimates for a regression adding an interaction term representing the simultaneous presence of both types of competitors (overbuilds and six over-the-air signals). . . . [the result] strongly suggests that while the economic value of overbuild competition can be quite high, the effects only occur when there does not already exist effective competition in the form of six over-the-air signals.[50]

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[49] See James N. Dertouzos and Steven S. Wildman, Competitive Effects of Broadcast Signals on Cable, 1990 (attachment to NCTA Comments, Competition, Rate Deregulation and the Commission's Policies Relating to the Provision of Cable Television Service, MM Docket No. 89-600, filed March 1, 1990). Dertouzos and Wildman concluded that five signals are sufficient to maximize the competitive effect that broadcast signals can have on cable rates and market behavior.

[50] Regulatory Benchmarks at 15.

While the Commission generally now discounts the competitive effects of multiple broadcast signals on cable rates, there is no doubt that broadcast television is a vibrant and highly profitable player in the video marketplace. And the Commission has, correctly, in the past given broadcast competitors their due in assessing the state of competition.[51]

In the 1990 Cable Report, the Commission recognized that different media provide competition for different components of cable service.[52] The availability of off-air broadcast television service is a good substitute for retransmitted broadcast signals and also offers some degree of competition to both broadcast-like as well as specialized basic cable programming services. But it is not a substitute for amenity services, such as exclusive sports, special events or commercial-free movie channels, which are available through VCR rentals or other means. The Commission found that cable operators have the ability to remove such high-cost "programming services from the basic tier -- and the evidence that many are doing so -- reaffirms our view that a sufficient complement of over-the-air signals provides an acceptable check" on basic cable prices."[53]

As the Commission noted in the NOI, the broadcast industry is looking to deliver multiple digitally-transmitted video signals within a single

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[51] See e.g., Reexamination of the Effective Competition Standard for the Regulation of Cable Television Basic Service Rates, Report and Order and Second Further Notice of Proposed Rulemaking, MM Docket Nos. 90-4 and 94-1296, 6 FCC Rcd 4545, released July 12, 1991.

[52] 1990 Cable Report at paras. 50 - 52.

[53] Reexamination of the Effective Competition Standard for the Regulation of Cable Television Basic Service Rates, MM Docket No. 90-4 , Second Report and Order, para. 6, released July 12, 1991.

channel in an effort to compete more vigorously with multichannel distributors. [54]

While such technological developments may enhance over-the-air broadcast capacity and efficiency, broadcasters already enjoy several advantages over other video providers. Broadcast television has nearly 100 percent penetration of television households via a free local distribution system. It also has a variety of statutory and regulatory protections, including must carry and channel positioning rights and retransmission consent rights. Broadcasters are also benefitting from resurging advertising revenues, the repeal of most of the financial interest and syndication rules and the network-cable crossownership rules.

While cable networks have increased their viewership, broadcast stations still dominate television viewing. Indeed, in the '93-'94 season, the broadcast networks, ABC-CBS-NBC, still maintained a 60.6 percent share of prime-time viewers, and if Fox is included, the share rises to 72 percent. Moreover, the long-term competitive viability of broadcast television is evidenced by the success of the Fox network, and the announced plans of Time Warner and Paramount to create new separate broadcast networks in conjunction with broadcast station groups.[55]

This healthy outlook prompted one media analyst to declare that "even with increased competition in the coming century from video-on-

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[54] "NAB '94: Reinventing its wheel", Broadcasting & Cable, March 28, 1994, at 6.

[55] "Warner Bros. Enters Race for Network", New York Times, November 3, 1993, at D1.

demand TV and pay-per-view, the broadcast networks should still be able to garner the lion's share of prime-time viewers." [56]

II. HORIZONTAL CONCENTRATION AND VERTICAL INTEGRATION

In the NOI, the Commission requests data that will create a baseline of the current state of horizontal ownership by MSOs and the current level of vertical integration in the cable programming industry. In establishing threshold data, NCTA has updated the horizontal concentration figures in Table 1 of Appendix G of the 1990 Cable Report and commissioned Economists, Inc. to update the remaining tables in Appendix G pertaining to vertical integration. In general, we find that there has been little change in the marketplace with regard to horizontal concentration and vertical integration since 1990.

A. Horizontal Concentration

As the Commission found in its 1990 Cable Report, and reiterated in its Second Report and Order in Docket 92-264 on horizontal and vertical ownership limits, "consolidation in the cable industry produced significant benefits and efficiencies to consumers" and "enabled 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."[57] Further, the Commission found that the growth of MSOs produced significant efficiencies in administration, distribution and

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[56] Paul Kagan Associates, Inc., "Video-On-Demand Effect on Broadcast Networks - 10 Year Forecast", May 27, 1994.

[57] 1990 Cable Report at ¶ 71.

procurement of programming which can promote the introduction of new video programming services." [58]

In enacting structural ownership limitations in the 1992 Cable Act, Congress instructed the Commission to balance the benefits and efficiencies of horizontal concentration with the competing risk that large MSOs might have the ability to preclude the launch of new programming services. The Commission thereupon adopted a 30 percent horizontal ownership limit. [59]

As shown in Attachment B, there has been little change in horizontal concentration in the cable industry since 1990. Tele-Communications, Inc. ("TCI"), the largest multiple system operator, has remained stable over the last four years, with a subscriber share of about 17.67 percent.[60] The second largest cable company is Time Warner Cable which reaches 12.2 percent of cable subscribers; each of the remaining twenty-three of the top twenty-five companies operate cable systems that serve less than 5.25 percent of the cable households.[61] Thus, under the present market

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58 Second Report and Order, MM Docket No. 92-264, released October 22, 1993. See also H.R. Rep No. 628, 102d Cong., 2d Sess. 43 (1992) ("House Report").

59 As the NOI notes, the Commission stayed implementation of the horizontal ownership restrictions pending the outcome of the appeal of the U.S. District Court decision holding such statutory restrictions unconstitutional. Daniels Cablevision v. United States, 835 F. Supp. 1 (D.D.C. 1993).

60 If subscribers data on cable companies in which TCI has an interest, accounted for by equity or cost methods is included, TCI would have approximately a 22.73 percent subscriber share.

61 If Comcast acquires Maclean-Hunter's cable systems, Comcast will have a 5.20 subscriber share. Cox Cable Communications and Times Mirror Cable also have agreed to merge. If the merger is completed, the new company will have a 5.17 percent share.

structure, there is no cable system that is close to the 30 percent horizontal concentration limit.

B. Vertical Integration

As with horizontal concentration, the Commission's vertical integration rules strike a balance between competing statutory objectives: ensuring that vertically-integrated cable operators do not favor affiliated video programmers, or unfairly impede the flow of video programming to cable subscribers, while encouraging MSOs to continue to invest in the development of diverse and high quality video programming services. The Commission adopted a 40 percent channel occupancy limit on the number of channels that can be occupied on a vertically integrated cable system by video programming in which the cable operator has an attributable interest.[62]

The Commission based its 1990 findings on vertical integration, as reported in Appendix G, largely on a study by Dr. Benjamin Klein, Professor of Economics at the University of California, Los Angeles.[63] Dr. Klein found that "[v]ertically integrated MSOs are somewhat more likely [than other operators] to carry their own programming networks," but that "there is no evidence that vertically integrated MSOs systematically exclude programming networks in which they do not have ownership interests."[64]

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62 Second Report and Order, MM Docket No. 92-264, released October 22, 1993.

63 B. Klein, The Competitive Consequences of Vertical Integration in the Cable Industry, June 1989, at 3. ("Klein Study") (attached to Comments of the National Cable Television Association, Inc., Horizontal and Vertical Ownership Limits, Cross-Ownership Limitations and Anti-Trafficking Provisions, MM Docket No. 92-264, filed February 9, 1993.)

64 Id. at 3.

According to Dr. Klein, foreclosing potential new entrants would not make economic sense because "it would not be profitable for vertically integrated MSOs attempting to obtain the best cable programming in order to maximize subscribership to systematically refuse carriage to new networks in which they do not have ownership interests." [65]

NCTA's analysis of the trends in vertical integration since the 1990 Cable Report indicates that, over the last four years, the number of national cable networks increased from 65 to 101. However, the percentage of national cable networks with cable operator ownership or equity interests *decreased* slightly from 58 percent in April 1990 to 56 percent in June 1994.

Moreover, 85 or roughly 44 percent of the 194 national, regional or planned cable networks have or will have no operator ownership involvement whatsoever. By comparison, in April 1990, 46 percent of national, regional or planned services were not vertically integrated with cable operators.

Indeed, according to Economists Inc. ("EI"), "as was the case in 1990, there are a significant number of cable networks that have no ownership links with MSOs." [66] Those networks include such popular and highly-rated services as Arts & Entertainment Network, CNBC, ESPN, Lifetime, The Disney Channel, and The Weather Channel.

In analyzing the carriage rates of cable networks by vertically-integrated and non-vertically integrated cable systems, EI used the random

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65 Id. at 30-31.

66 See Economists Incorporated, Cable Network Carriage Analysis Update ("EI Report"). See Attachment C, EI Report Table 1, which lists the national satellite networks with cable operator ownership or equity interest and EI Report Table 2, which lists the networks with no cable operator ownership or equity interest.