BEFORE THE

Federal Communications Commission

WASHINGTON, D.C.

RECEIVED

JUL 29 1994

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of	)	
	)	
Implementation of Sections of the	)	
Cable Television Consumer Protection	)	MM Docket 92-266
and Competition Act of 1992,	)	
	)	
Rate Regulation	)	
	)	
Fifth Notice of Proposed Rulemaking	)	

REPLY COMMENTS OF TELE-COMMUNICATIONS, INC.

WILLKIE FARR & GALLAGHER
Three Lafayette Centre
1155 21st Street, N.W.
Suite 600
Washington, D.C. 20036-3384

Its Attorneys

July 29, 1994

TABLE OF CONTENTS

PAGE NO.

SUMMARY

The record clearly establishes that no statutory, policy, or economic rationale justifies regulation of commercial rates. Based on this overwhelming record, TCI urges the Commission to rule that commercial rates are not subject to rate regulation.

With respect to the revision of its going-forward methodology, the Commission should:

- apply TCI's "competitive markup" to <u>all</u> services, including transaction-related services;
- not impose a regulatory cap on annual price increases due to the addition of new regulated services;
- eliminate the prior-approval requirement for basic-tier rate increases;
- remove franchising authority jurisdiction over <u>a la carte</u> offerings; and
- simultaneously clarify the various NII upgrade incentive mechanisms while revising its going-forward methodology.

Finally, the Commission should avoid rules that impair operator flexibility to rearrange service offerings, including the movement of regulated services to unregulated status. Most importantly, proposals to further entrench existing programmers on regulated tiers should be rejected. As Congress and the Commission have recognized, rearrangement of service offerings can increase program options and the ability of consumers to control their program choice. The Commission should adopt guidelines that constrain truly evasive behavior, but, at the same time, are flexible enough to permit operators to take actions that increase consumer choice.

BEFORE THE

Federal Communications Commission

WASHINGTON, D.C.

RECEIVED
JUL 2 9 1994
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

In the Matter of	)	
	)	
Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992,	)	MM Docket 92-266
	)	
Rate Regulation	)	
	)	
Fifth Notice of Proposed Rulemaking	)	

REPLY COMMENTS OF TELE-COMMUNICATIONS, INC.

Tele-Communications, Inc. ("TCI") hereby files its reply comments in the above-captioned proceeding.[1]

I. THE RECORD UNANIMOUSLY DEMONSTRATES THAT NO STATUTORY, POLICY, OR ECONOMIC RATIONALE, JUSTIFIES REGULATION OF COMMERCIAL RATES

The record clearly establishes that no statutory, policy, or economic rationale justifies regulation of commercial rates.[2]

---

[1] Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation, Second Order on Reconsideration, Fourth Report and Order, and Fifth Notice of Proposed Rulemaking, MM Docket No. 92-266, FCC 94-38, released March 30, 1994 ("Second Rate Reconsideration Order," "Fourth Report and Order," or "Fifth NPRM").

[2] See, e.g., Comments of Affiliated Regional Communications at 3-14; Comments of Cable Telecommunications Association at 8-10; Comments of Cablevision Industries Corporation at 16-23; Comments of Cablevision Systems Corporation at 3-9; Comments of Continental Cablevision at 1-16; Comments of NCTA at 16-19; Comments of The National Hockey League at 3-11; Comments of Pagosa Vision, Inc. at 3-4; Comments of Providence Journal, et al. at 11-12; Comments of Rainbow Programming Holdings, Inc. at 2-7; Comments of TCI at 33-41; Comments of Time Warner at 29-46.

In the aggregate, the comments show that:

- the language of the statute speaks solely in terms of "homes," "households," and "residences," indicating that Section 3 covers only residential subscribers;

- the legislative history contains no reference to the regulation of commercial rates; and

- the dramatic differences between residential and commercial cable service demonstrate that it was logical for Congress to choose not to regulate commercial rates.

In light of this overwhelming record, TCI respectfully urges the Commission to rule that commercial rates are not subject to the rate regulation rules.

II. GOING-FORWARD METHODOLOGY

A. Overview

An equally compelling consensus is established in the record regarding the inability of the Commission's current going-forward methodology to provide operator incentives to add new services to regulated tiers. Among other things, commenters propose: (1) replacement of the current markup scheme;[3] (2) elimination of the prior-approval requirement for basic-tier rate increases;[4]

---

[3] See Comments of Cable Telecommunications Association at 2-5; Comments of Cablevision Industries Corporation at 13-14; Comments of Court TV at 15; Comments of Discovery at 3, 7; Comments of E! Entertainment Television, Inc. at 3-4; Comments of Jones Education Network at 6; Comments of Liberty at 7; Comments of Lifetime at 15; Comments of NCTA at 8; Comments of Providence Journal, et al. at 6; Comments of TCI at 21-29; Comments of Time Warner at 6; Comments of Times Mirror Company at 5; Comments of USA Networks at 9-10; Comments of Viacom at 8-9.

[4] See Comments of Liberty at 16-17; Comments of Lifetime at 20; Comments of Providence Journal, et al. at 15-18; Comments (continued...)

and (3) limiting the scope of review triggered by an upper-tier complaint to the rate increase rather than the underlying rate structure.[5] TCI continues to support all of these changes as necessary components of a viable going-forward methodology.

B. Markup Scheme

Several parties suggest that the appropriate markup when adding new regulated services should be based on an examination of the historical behavior of cable systems when channels were actually added in the past.[6] This approach formed the basis for TCI's $.25 markup proposal described in its initial comments.[7] TCI reiterates its support for this "competitive markup approach." Moreover, TCI responds to specific issues relating to the markup in the following sections.

---

[4](...continued) of TCI at 4-10; Comments of Time Warner at 16-18; Comments of Viacom at 11-17.

[5] See Comments of Discovery at 11; Comments of Liberty at 16; Comments of Lifetime at 18; Comments of NCTA at 9-10; Comments of Providence Journal, et al. at 18-20; Comments of TCI at 12-13; Comments of Time Warner at 18-20; Comments of Viacom at 17-20.

[6] See Comments of Cablevision Industries Corporation at 13; Comments of Liberty Media Corporation at 15; Comments of NCTA at 6.

[7] See Comments of TCI at 21-29 and accompanying Appendix, Drs. Stanley M. Besen and John R. Woodbury, "A Competitive Markup Approach to Establishing Rates When Adding Cable Program Services," June 29, 1994 ("Besen and Woodbury").

1. **The Competitive Markup Should Apply to <u>All</u> New Regulated Services, Including Transaction-Based Services**

Several parties suggest that the markup on new regulated services should not apply to the addition of "transaction-related" channels, such as home shopping networks, which, they contend, "are based on a different economic model than traditional programming services."[8] Presumably, these commenters believe that the fact that payments for home shopping services run from the programmer to the operator disqualifies these services from eligibility for a markup.

As an initial matter, these commenters fail to recognize that many cable services other than home shopping channels rely, to some degree, on an "economic model" which has revenues flowing downstream to the operator. Indeed, this phenomenon is likely to become even more prevalent as "traditional" cable services introduce the sale of merchandise as a part-time offering. Downstream payments may take other forms, as well, including providing advertising availabilities, offering launch incentives, etc. In short, the logic on which the proposed disqualification of home shopping services is based would arguably call for the elimination of a markup (or a portion thereof) on many "traditional services" as well, a result that would ultimately

---

[8] Comments of A&E and ESPN in Support of Petitions for Reconsideration, filed in MM Docket No. 92-266, June 16, 1994, at n. 12 ("A&E/ESPN Comments"); <u>ex parte</u> filing of Lifetime Television in MM Docket No. 92-266, July 5, 1994, at 1.

harm consumers by discouraging the creation and distribution of new and diverse programming services for the regulated tiers.

On a more fundamental level, the proposed disqualification of home shopping services stems from the failure of various markup proposals to address adequately the treatment of revenue offsets. A preferable approach is to adopt a markup scheme that already accounts for revenue offsets in a principled manner. A primary virtue of TCI's "competitive markup" proposal is that it avoids the need to deal with "offsets," such as additional advertising revenues, because it is based on an economic analysis of historic cable industry practices that <u>already</u> takes into account these offsets.

In this regard, offsets that come from commissions on sales of merchandise are no different from those that result from advertising revenues. The mere fact that the payment structure of home shopping channels may be different from other services does not change this fact, nor does it necessarily suggest that the appropriate markup for home shopping services is somehow below average.

Accordingly, TCI urges the Commission to reject all proposals to disqualify any class of regulated services from eligibility for a markup. Rather, it should simply adopt a markup scheme that accounts for all revenue offsets, as does TCI's competitive markup proposal.

2. **An Annual Cap on the Markup Should Not Be Adopted**

Several commenters propose that the Commission adopt an annual cap on increases in subscriber rates caused by the addition of new networks.[9] TCI opposes the imposition of such an annual cap either on the markup, the increases in license fees, or a combination of the two.

A regulatory cap on price increases would encourage operators to delay, or wholly abandon, the introduction of new services. If the addition of a new service would cause the operator to exceed such an artificial annual cap, the operator will be motivated to postpone offering the service until it can recover its costs, or to cancel its plans to add the new service altogether. This outcome is fundamentally at odds with the Commission's expressed desire to adopt going-forward rules that "assur[e] the continued growth of the cable industry and the additional services that it can provide to subscribers."[10] Thus, the Commission should reject proposals for an annual (or even bi-annual[11]) regulatory cap.

---

[9] See, e.g., A&E/ESPN Comments at n. 17; Comments of Discovery at 8; Comments of Lifetime at 15-16; Comments of Providence Journal, et al. at 6; Comments of Viacom at 9-10.

[10] Fourth Report and Order at ¶ 231.

[11] See Comments of Cablevision Industries Corp. at 14.

C. Procedural Issues

1. The Record Overwhelmingly Demonstrates That a Prior-Approval Pass-Through Scheme for Basic-Tier Rate Increases Is Unjustifiable as Both a Legal and Policy Matter

As noted above, almost all commenters agree that a principal deterrent to adding new regulated services to the basic tier is the "prior-approval requirement" for basic-tier external cost pass throughs.[12] Only NATOA objects[13] to the proposal advanced by many commenters to allow basic-tier external costs to be automatically passed through to subscribers after 30 days notice, subject to refund liability ("30-day pass through + refund scheme").[14]

NATOA's objection appears to be based on the mistaken belief that if a franchising authority does not complete its review of a proposed rate increase within 30 days, then it may not thereafter act to determine whether the implemented rate is reasonable. For example, NATOA's comments focus on the fact that a 30-day review period is insufficient to determine the reasonableness of a rate increase,[15] and that franchising authorities must have the right to "extend the initial 30-day rate review period if necessary to

---

12 See, supra, n. 4.

13 See Opposition of NATOA, et al. to Petitions for Reconsideration, filed in MM Dockets 92-266 on June 16, 1994 (NATOA Opposition").

14 See, e.g., Comments of Providence Journal at 15-18; Comments of TCI at 8-10; Comments of Time Warner at 16-18; Comments of Viacom at 11-17.

15 NATOA Opposition at 5-6 and n. 9.

ensure that a proposed external cost rate increase is properly evaluated for its reasonableness."[16]

However, proponents of the "30-day pass through + refund scheme" do <u>not</u> advocate that a basic-tier pass through that is not reviewed within 30 days may <u>never</u> be reviewed. In fact, TCI and others have already agreed that the extended review periods under 47 C.F.R. § 76.933 would still apply to pass-through proceedings.[17] The central issue is whether these extended review periods may be implemented as part of a <u>prior-approval</u> pass-through scheme whose only effect is to prolong substantially an operator's recovery of external costs. As the record overwhelmingly demonstrates, no policy or legal justification exists for such a prior-approval approach. This is especially true given the availability of the refund mechanism if the franchising authority ultimately finds (within the Section 76.933 extended review periods) that the pass through is unreasonable.

---

[16] <u>Id.</u> at 5.

[17] <u>See</u> TCI comments at 8 ("If the franchising authority completes its review of the rate justification form within this '30-day window,' and finds the proposed rate increase unreasonable, it may prevent, or reduce, the increase. Thereafter, <u>if, within the time frames established in 47 C.F.R. §§ 76.933(b) and (c),</u> the franchising authority finds the increase (or a portion of the increase) unreasonable, it may order refunds") (emphasis added). <u>See</u> <u>also</u> Comments of Programming Providers, filed in MM Docket No. 92-266 on May 16, 1994, at 19.

2. The Commission Should Remove Franchising Authority Jurisdiction Over A La Carte Offerings

All parties commenting on the issue, except NATOA, support the removal of franchising authority jurisdiction to determine the regulatory status of a la carte offerings.[18]

NATOA argues that local jurisdiction in this area is required because:

> otherwise franchising authorities would be forced to accept basic service tier rates that are at unreasonable levels merely as a result of the fact that they cannot take into account in establishing the basic rate an 'a la carte' tier that might be subject to regulation under the Commission's rules because it is not a true 'a la carte' offering.[19]

NATOA is mistaken in suggesting that without local jurisdiction in this area franchising authorities would be forced to accept potentially unreasonable basic-tier rates. In fact, as TCI noted in its initial comments, a more efficient and equitable approach, and one that maintains franchising authorities' enforcement powers, is to restore exclusive jurisdiction in this area to the FCC and allow franchising authorities to challenge (before the Commission) any collective a la carte offering by an operator.[20]

TCI's approach is preferable from a policy standpoint because it minimizes regulatory delay, affords greater certainty (since potentially inconsistent a la carte decisions by thousands

---

[18] See, e.g., Comments of Programming Providers, filed in MM Docket No. 92-266 on May 16, 1994, at 22-24; Comments of TCI at 15-16.

[19] NATOA Opposition at 2-3.

[20] TCI Comments at 15-16.

of franchising authorities would be avoided), and does not create a bias against the creation of legitimate, pro-consumer a la carte offerings. Moreover, the interests of franchising authorities and consumers are fully protected by the ability of franchising authorities to challenge any a la carte offering.

Finally, as TCI noted in its initial comments, such a jurisdictional scheme is required as a legal matter, since a la carte offerings, if ultimately found to be regulated, would be cable programming service tiers, and the 1992 Cable Act confers exclusive jurisdiction over such tiers to the Commission.[21]

3. The Commission Should Simultaneously Clarify Its Various NII Upgrade Incentive Mechanisms While It is Revising Its Going-Forward Methodology

In its initial comments, TCI stressed that in addition to providing operators with incentives to add regulated services, the Commission must simultaneously create incentives to develop and deploy broadband, interactive unregulated offerings.[22] If operators know they can recover their costs and a reasonable markup by adding regulated services, but are presented with little corresponding incentive to upgrade their cable plants to offer advanced, unregulated offerings, the emergence of the

---

[21] TCI Comments at 15 (citing, inter alia, Rate Order at ¶ 350 ("[A]bsent specific authority to delegate our adjudicatory and enforcement powers we are unable to delegate such powers to the local franchising authorities in the cable programming context")).

[22] Comment of TCI at 3-4.

National Information Infrastructure will be substantially delayed. As Besen and Woodbury have described it:

> If the Commission fails to create incentives for system upgrades, operators will not undertake the necessary plant investment and consumers will have only the choice of demanding more traditional regulated services. As a result, programmers will invest more in these traditional services and invest less in the more innovative offerings.[23]

Part of the problem is that many of the pieces of a broader going-forward methodology are addressed in various FCC proceedings. For example, even with respect to the short-term going-forward rules, some parties filed comments on the Fifth NPRM; others submitted petitions for reconsideration of the Second Rate Reconsideration Order, Third Rate Reconsideration Order, and/or Fourth Report and Order. In addition, many issues that will affect both short- and long-term operator incentives are addressed in the cost-of-service proceeding, for example, treatment of affiliated transactions, productivity offset, streamlined cost-of-service upgrades, incentive upgrade plan, etc.

To avoid inconsistent policies that will spring out of such a diffuse approach, TCI urges the Commission to pursue a simultaneous, two-track approach that endeavors to clarify the various NII upgrade incentive mechanisms while at the same time revising the going-forward methodology for adding regulated services. Only through such concurrent consideration of these important issues can the Commission hope to establish a balanced

---

[23] Besen and Woodbury at 18.

approach that gives equal weight to short-term and long-term incentives, thereby allowing customer preferences and marketplace forces, rather than regulatory constraints, to drive operator investment and program offerings.

III. THE COMMISSION SHOULD NOT ADOPT RULES THAT IMPAIR OPERATOR FLEXIBILITY TO REARRANGE SERVICE OFFERINGS, INCLUDING THE MOVEMENT OF REGULATED SERVICES TO UNREGULATED STATUS

A. Overview

In its initial comments, TCI proposed that the $.25 competitive markup should apply to all new regulated services up to 75 regulated channels; beyond 75 regulated channels, the Commission's rate regulation scheme would not apply.[24] As TCI noted, this bifurcated regulatory scheme protects consumers since they will be assured of 75 channels of cable service at a regulated rate which will be capped on a going-forward basis. At the same time, this approach would encourage greater operator investment in infrastructure and new technologies, as well as enhanced diversity in regulated offerings.[25] TCI reiterates its support for this proposal.

However, TCI recognizes the Commission's concern that such a bifurcated regulatory approach may create incentives for the repackaging of services from "below-75" status to "above-75" status. This concern is similar to the one raised in the a la carte context by several commenters; both focus on the shifting

---

[24] Comments of TCI at 31.

[25] Id. at 32.

of regulated programming to an unregulated status as a means of avoiding rate regulation. While TCI understands these concerns, it respectfully submits that they are overstated for the reasons discussed in the following sections.

B. Operator Rearrangement of Service Offerings is a Legitimate Business Practice and is Unlikely to be Done Merely to Evade Rate Regulation

Concerns about possible evasions of the Commission's rate rules have tended to overshadow the fact that an operator's rearrangement of service offerings is motivated by a desire to serve its subscribers better rather than to evade rate regulation. For example, much of the concern and confusion associated with _a la carte_ offerings is the result of a labelling problem. "_A la carte_," "_a la carte_ tier" and "_a la carte_ package" are widely used, and often used interchangeably, yet a clear definition for these terms is lacking. As a result, many have lost sight of the inherent consumer benefits afforded by _a la carte_ offerings and have begun to equate the movement of any service to "_a la carte_" with an attempt to evade rate regulation. Such inaccurate labelling will drive poor policy decisions.

TCI uses the term "_a la carte_" to mean program services that are available to consumers individually, on a positive option basis, and priced in such a way that consumers have a real choice to purchase these services separately. TCI envisions "_a la carte_ packages" to mean offering to consumers program services that are otherwise available for purchase on a per channel basis but that are also available as a collective "package" purchase. The operator may offer marketing incentives to consumers to purchase the "package" in order to drive volume in sales. But, should consumers nonetheless wish to purchase individual services, they will be able to do so at a reasonable rate.

Thus, at each turn, TCI's a la carte offerings will constitute a legitimate business practice aimed at enhancing consumer choice. Of course, both the legislative history of the 1992 Cable Act and the Commission's orders have repeatedly recognized the significance of a la carte offerings as a means of increasing subscriber choice in the purchase of cable service.[26] TCI urges the Commission to be guided by this principle as it considers revisions to its a la carte rules. While the Commission may inquire into whether particular a la carte offerings constrain consumer choice, it should not lose sight of the fact that the rearrangement of a cable operator's services, including the creation of collective a la carte offerings, so long as they are offered on a positive option basis and with a real opportunity for purchase of individual services, is a

---

[26] See S. Rep. No. 102-92, 102d Cong., 2d Sess. (1992) ("[O]ne of the prime goals of the legislation is to enhance subscriber choice. Unbundling [of program services] is a major step in this direction. Cable operators and programmers are urged to work toward this objective"); First Rate Reconsideration Order at ¶ 35 ("restructuring program offerings to provide more a la carte services is not per se undesirable.... [Such arrangements] increase[] consumer choice, which is one of the goals of the Act") (citation omitted); Rate Order at ¶ 327 (providing for unregulated treatment of collective offerings of a la carte channels affords operators an opportunity to enhance consumer choice by making programming more affordable and more widely available); Second Rate Reconsideration Order at ¶¶ 192-194 (same).

legitimate business practice that should be encouraged, not stifled.

Moreover, in today's marketplace, operators have little incentive to shift channels from regulated tiers merely to evade rate regulation, because such a strategy would be counter-productive from both a revenue and consumer satisfaction perspective.[27] For example, a 150-channel cable system would never replace 60 non-broadcast services on its regulated tiers with low-cost, low-quality channels merely so it could shift the original services to the above-75 unregulated realm and thereby evade rate regulation. Because of the Commission's buy-through rules, such a strategy would likely cause subscribers to drop their subscriptions to the regulated tiers. The result would be nonsensical: The operator would incur all the costs of constructing the 60 channels, but would forgo any serious opportunity to recover the costs and earn a reasonable return on such costs. Even where the operator, for legitimate reasons, wants to shift a small number of channels from regulated to unregulated status, a preferable strategy would be to replace them with new and valuable services, thereby increasing the quality of overall system offerings and enhancing consumer choice.

Finally, cable operators increasingly will be constrained from engaging in evasive behavior by the mounting competitive

[27] See also Comments of Cablevision Industries Association at 9, 13; Comments of NCTA at 9.

threat they face from alternative video distributors. DBS recently initiated service, and all accounts indicate that demand for DBS receivers is outstripping supply.[28] In addition, the Commission recently approved the nation's first commercial video dialtone system -- a $16 million, 384-channel, interactive video platform passing 38,000 homes in Dover Township, N.J.[29] -- and it is reported that the Commission will shortly grant additional video dialtone applications. Lastly, MMDS, HSD, and SMATV continue to garner increased subscribership.

It is well-established that if a firm with a relatively low market share can easily expand its output in response to a price increase by a larger firm, the smaller firm would restrain the ability of the larger firm to implement such an increase. This is particularly likely to occur if the investment required by a distributor to enter the market is relatively large, but the distributor's costs to add customers thereafter is relatively small.[30] Of course, this is the case in the video distribution market where it would be relatively inexpensive for alternative video distributors, such as DBS or video dialtone, to raise output in response to a price increase by cable operators. Consequently, cable operators will be additionally constrained

---

[28] See Kent Gibbons, "DBS Companies Report Strong Sales at Launch," Multichannel News, June 27, 1994, at 4.

[29] Order and Authorization, File No. W-P-C-6840, FCC 94-180, released July 18, 1994.

[30] See F.M Scherer & D. Ross, Industrial Market Structure and Economic Performance 289 (Third Edition, Houghton Mifflin Co. 1990).

from undertaking service rearrangements that effectively raise subscriber rates without concomitantly increasing programming quality and subscriber choice.

C. The Commission Must Reject All Proposals To Further Entrench Existing Programmers on the Regulated Tiers

Despite the pro-consumer effects often generated by the repackaging of regulated services as unregulated offerings, certain commenters would nevertheless have the Commission believe that any movement of regulated services to unregulated status is presumptively or per se impermissible. For example, Lifetime opposes all proposals that would allow the movement of a fixed number of regulated services to unregulated carriage, even where the movement is limited to services that have contractually agreed to being offered on a standalone basis.[31] Similarly, several established programmers, in a thinly disguised effort to entrench their carriage on regulated tiers, argue that the markup should not apply when new regulated channels are substituted for old ones.[32] The Commission should recognize these and other similar programmer proposals for what they are: self-serving efforts to have the government renegotiate their contracts

---

[31] Comments of Lifetime at 16.

[32] Comments of Discovery at 7; Comments of Lifetime at 13-14. See also Comments of Viacom at 6-7. Lifetime's proposal is even more absurd in that it would prohibit as "veiled switch-outs" the deletion of an existing regulated service and the subsequent addition of a new programming service to the regulated tier. Comments of Lifetime at 13-14. Under this proposal, operators would be discouraged from ever deleting existing regulated services for fear of triggering regulatory scrutiny. Of course, this result is fundamentally at odds with one of the Commission's principal objectives in this proceeding.

retroactively in order to lock in their favored status on regulated tiers.[33] For the reasons discussed below, TCI emphatically opposes all such proposals.

Preventing or discouraging operators from moving program services from regulated to unregulated status would confer on existing programmers inordinate leverage to raise their rates indiscriminately to cable operators. Consumers will be the ultimate victims of this excessive programmer leverage, since any increase in existing programmer rates will be passed on to subscribers as higher regulated rates. Alternatively, if the operator opts to drop the programmer from its system rather than pay the rate increase, consumers will be harmed by the loss of a regulated service. Neither outcome is in the public interest.

This same result would occur if the Commission were to permit movement of an existing service to unregulated status only where the operator simultaneously retained carriage of the service on a regulated tier, i.e., it offered the service both in a regulated tier and as part of an a la carte offering. Here, again, the leverage accorded the programmer by its further entrenchment on the regulated tier would result either in substantial subscriber rate increases or the loss of the service altogether. This approach has the added downside of requiring,

[33] Ironically, the very same programmers who would have the Commission minimize operator flexibility in moving services off regulated tiers also recommend the adoption of guidelines that would maximize operator incentives to "reverse migrate" a la carte services to regulated tiers. See, e.g., Comments of Discovery at 10; Comments of Lifetime at 17; Comments of Viacom at 10-11.

in most instances, two channels to deliver a single service, a significant waste of capacity to many channel-constrained systems.[34] This approach could also result in certain subscribers paying twice for the same service if the subscriber maintains his subscription to the regulated tier on which the service is retained in addition to subscribing to a collective a la carte offering to which the service was moved.

In addition, locking in existing programmers would deal a severe blow to new programmers who would be deprived of slots on the highly-coveted regulated tiers. Affording incumbent programmers such squatter's rights not only contravenes the Commission's stated desire to design a going-forward methodology that will encourage the carriage of new programmers on regulated tiers, but it also will drive up marketing costs for new services to prohibitive levels and limit their opportunities for success.

Accordingly, the Commission should reject all proposals that further entrench existing services on regulated tiers or limit an operator's ability to rearrange its various regulated and unregulated service offerings. At a minimum, the Commission should make clear that nothing in its rules limit any rights an

---

[34] Two distinct channels would be required because, in most instances, the operator cannot carry the program service only once and use technology to offer it as part of both a regulated and unregulated offering. This is so because: (1) consumers may opt to bypass the regulated tier and subscribe only to the a la carte offering (see Buy-Through Prohibition, 47 C.F.R. § 76.900); and (2) each channel on a cable system is typically not individually controlled through addressable security, so that an operator would not be able to block out all channels on the regulated tier except for the service that is also available as an a la carte offering.

operator may have obtained contractually to offer particular services on an a la carte basis. Incumbent program services should not be permitted to wield the Commission's rules as a sword against cable operators and consumers in order to extract greater signal carriage rights than they obtained contractually.

D. Proposals for Commission Action

As noted above, the rearrangement of a cable operator's service offerings is a legitimate business practice that should be encouraged, not stifled. As Congress and the Commission have recognized, such service arrangements permit the operator to serve its customers better by increasing the diversity of programming options available, while simultaneously increasing customers' control over their programming purchases.[35] Moreover, for the reasons stated above, operators are unlikely to engage in such activity simply to evade rate regulation.

However, to the extent the Commission is still concerned about the possibility of evasive behavior, it has regulatory authority to address this issue without unduly affecting the ability of operators to respond to consumer demand by creating different program package options.

The Commission can accomplish this result by establishing clear guidelines for what constitutes evasive behavior and penalizing only those operators who engage in such behavior.[36] Toward this end, the Commission should expeditiously resolve the

---

[35] See, supra, n. 26.

[36] See Comments of TCI at 33.

pending letters of inquiry focused on the shifting of regulated services to unregulated status and establish in its letter rulings the types of _a la carte_ packaging/marketing strategies that are permissible, so that operators will have a clear line of precedent to follow when they rearrange their various service offerings.

In developing these guidelines, TCI urges the Commission to recognize that, for the reasons described above, the problem of evasion is likely to be a limited one which warrants a correspondingly limited solution. The Commission should not adopt rules that are more burdensome than necessary and which will, in turn, create serious regulatory distortions. In short, the Commission should adopt guidelines that constrain truly evasive behavior, but at the same time, are flexible enough to permit operators to take actions that increase consumer choice.

CONCLUSION

For the reasons set forth above, TCI respectfully urges the Commission to revise its going-forward methodology and to adopt rules regarding commercial rates consistent with the comments herein and with TCI's initial comments.

Respectfully submitted,

TELE-COMMUNICATIONS, INC.

Michael H. Hammer

Michael H. Hammer
Francis M. Buono

WILLKIE FARR & GALLAGHER
Three Lafayette Centre
1155 21st Street, N.W.
Suite 600
Washington, D.C. 20036-3384

Its Attorneys

July 29, 1994

92340248