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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554 SEP 29 2 53 PM '94

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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	)	

FIRST REPORT

Adopted: September 19, 1994 **Released: September 28, 1994**

By the Commission:

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Paragraph

I.
INTRODUCTION

1. Pursuant to the Cable Television Consumer Protection and Competition Act of 1992 (the "1992 Cable Act" or "the Act"),[1] the Commission is required to report to Congress annually "on the status of competition in the market for the delivery of video programming."[2] This report (the "*Report*" or the "*Competition Report*") is the first of these annual competition studies.[3]

A. Evolving View of Competition in the Market for the Delivery of Video Programming

2. In the ten years since Congress enacted the first major statute addressing the cable industry -- the Cable Communications Policy Act of 1984[4] -- the view of competition in the market for the delivery of video programming has evolved, both in Congress and at the Commission. As the Commission recognized in the report on competition in the cable television industry that it issued in 1990,[5] Congress enacted the 1984 Cable Act to encourage the growth of cable systems, the development of cable services and the provision of diverse

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[1] Pub. L. No. 102-385, 106 Stat. 1460 (amending the Communications Act of 1934 (the "Communications Act") and codified at 47 U.S.C. § 151, *et seq.*).

[2] Communications Act § 628(g), 47 U.S.C. § 548(g) (requiring the Commission to report to Congress "beginning not later than 18 months after promulgation of the regulations required by [Section 19(c) of the 1992 Cable Act]"). Those regulations were adopted on April 1, 1993. *Implementation of Sections 12 & 19 of the 1992 Cable Act -- Dev. of Competition & Diversity in Video Programming Dist. & Carriage, First Report & Order ("Program Access Report & Order")*, 8 FCC Rcd 3359 (1993), *recon. pending* MM Docket No. 92-265. Consequently, the *Report* is due on October 1, 1994.

[3] The Commission began this study with a notice of inquiry, which it released May 19, 1994. *Implementation of Section 19 of the 1992 Cable Act -- Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, Notice of Inquiry*, 9 FCC Rcd 2896 (1994) ("*NOI*"). In response to the *NOI*, the Commission received comments and reply comments, some of which were not timely filed. In the interest of compiling as complete a record as possible, those late-filed pleadings are accepted and have been considered in this *Report*. The Commission also received numerous *ex parte* submissions, copies of which have been placed in the record. A list of those comments, reply comments and other submissions is set forth in Appendix A.

[4] Cable Communications Policy Act of 1984, Pub. L. No. 98-549, 98 Stat. 2779 (codified as amended by 1992 Cable Act at 47 U.S.C. § 151, *et seq.*) (1984) ("1984 Cable Act" or "1984 Act").

[5] *Rate Deregulation & the Commission's Policies Relating to the Provision of Cable Television Serv., Report on Competition*, 5 FCC Rcd 4962 (1990) ("*1990 Cable Report*").

sources of information.[6] Accordingly, one of the primary purposes of the 1984 Cable Act was to "promote competition in cable communications and minimize unnecessary regulation that would impose an undue economic burden on cable systems."[7]

3. To fulfill this Congressional purpose, the 1984 Act imposed various limitations on the authority of local government entities to regulate cable services and, in particular, permitted regulation of basic cable rates only where, pursuant to Commission-established criteria, "a cable system is not subject to effective competition."[8] The Commission later determined that "effective competition" existed when at least three unduplicated broadcast television signals were "available" to the cable community.[9] In essence, that determination deregulated the rates of approximately ninety-seven percent of all cable franchises.[10]

4. The 1984 Cable Act was a success in many ways. The number of communities and homes served by cable grew dramatically, channel capacity increased, and new programming was created.[11] However, as the Commission found in its *1990 Cable Report*, there was little competitive constraint on cable market power after passage of the 1984 Act, and cable system operators were able to collect monopoly profits through the imposition of significant rate increases on subscribers.[12]

5. In response to those trends, Congress passed the 1992 Cable Act, which in essence, re-regulated the cable industry. In enacting the 1992 Cable Act, Congress found that "[t]he average monthly cable rate has increased almost 3 times as much as the Consumer Price Index ["CPI"] since rate deregulation [under the 1984 Cable Act]."[13] Congress also found that without competition, there was "undue market power for the cable operator as compared to that of consumers and video programmers," and that "the cable television industry has become a dominant nationwide video medium."[14] However, Congress

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[6] *Id.* ¶¶ 1-5, 5 FCC Rcd at 4964-68.

[7] Communications Act § 601(g), 47 U.S.C. § 521(6).

[8] 1992 Cable Act sec. 2, 106 Stat. at 1460.

[9] 47 C.F.R. § 76.33(a) (1985) (superseded).

[10] 1992 Cable Act, sec. 2(a)(1), 106 Stat. at 1460.

[11] H.R. REP. NO. 862, 102d Cong., 2d Sess. 56 (1992), *reprinted in* 1992 U.S.C.C.A.N. 1231, 1238; S. REP. NO. 92, 102d Cong., 1st Sess. 3 (1991), *reprinted in* 1992 U.S.C.C.A.N. 1133, 1135-36; *1990 Cable Report* ¶ 3, 5 FCC Rcd at 4966.

[12] *1990 Cable Report* ¶ 13, 5 FCC Rcd at 4972-73.

[13] 1992 Cable Act, sec. 2(a)(1), 106 Stat. at 1460.

[14] 1992 Cable Act secs. 2(a)(2-3), 106 Stat. at 1460.

specifically articulated as a central and critical goal of the legislation a "[p]reference for competition," as opposed to rate regulation of cable systems.[15] Accordingly, the 1992 Act generally provides that where a cable system is subject to effective competition, its rates shall not be subject to governmental regulation.[16]

6. As the Commission recognized in the *NOI*, the 1992 Cable Act's regulatory scheme serves as a "transitional mechanism until competition develops and consumers have adequate multichannel video programming alternatives."[17] Moreover, promotion of the emergence of effective competition through the entry of alternative distribution technologies is a critical element of the regulatory framework mandated by Congress.[18] The Commission has adopted rules implementing this mandate; in particular, regulations requiring that programming be made available to competing distributors on non-discriminatory terms, and prohibiting cable operators from discriminating against unaffiliated programmers on the terms and conditions of carriage.[19] In this manner, the Commission has sought to inhibit anticompetitive abuses and to foster the emergence of a competitive market for the delivery of video programming to consumers.

B. Scope of the *Report*

7. Through this *Report* and future reports, the Commission intends to provide Congress with information regarding the state of competition in the market for the delivery of video programming, with a particular emphasis on the cable television industry. Accordingly, this *Report* provides data and information on: cable industry performance (Section II); the status of entry by Multichannel Video Program Distributors ("MVPDs"), including those that use technologies other than cable (Section III); and structural issues

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[15] Communications Act § 623(a)(2), 47 U.S.C. § 543(a)(2).

[16] *Id.*

[17] *NOI* ¶ 2, 9 FCC Rcd at 2896.

[18] *See* 1992 Cable Act, secs. 2(b)(1-2) (articulating Congressional policy to "promote the availability to the public of a diversity of views and information through cable television and other video distribution media" and to "rely on the marketplace, to the maximum extent feasible, to achieve that availability"); Communications Act § 623(a), 47 U.S.C. § 543(a) (prohibiting rate regulation if the Commission "finds that a cable system is subject to effective competition" and defining "effective competition" with specific regard to competition to cable from other "multichannel video programming distributors").

[19] *See generally Program Access Report & Order*, 8 FCC Rcd 3359; *Implementation of Sections 12 & 19 of the 1992 Cable Act -- Dev. of Competition & Diversity in Video Programming & Carriage, Second Report & Order ("Program Carriage Report & Order")*, 9 FCC Rcd 2642 (1993), *recon. granted, Memorandum Opinion & Order,* FCC 94-203 (MM Docket No. 92-265 Aug. 5, 1994).

affecting entry, such as vertical integration, horizontal concentration, and technological advances (Section IV). Also included in Section IV are preliminary assessments of the impact of the 1992 Act and of the Commission's regulations on access to video programming services by competing MVPDs.

8. Section V of the *Report* contains the Commission's analysis of the extent of competition in the market for the delivery of video programming, and an assessment of market performance. A discussion of future action by the Commission to study the cable industry and to prepare for future reports is also included in Section V.

9. In preparing this *Report*, the Commission has been mindful of the rate regulation provisions of the 1992 Act, which exempt from rate regulation cable systems subject to "effective competition."[20] As described more fully below, the 1992 Cable Act defines "effective competition" to exist when: (a) a franchise area is served by at least two unaffiliated MVPDs, each of which offers comparable video programming to at least 50% of the households in the franchise area; and (b) at least 15% of the households in the franchise area subscribe to service from MVPDs other than the largest one.[21] The statute also defines effective competition to exist when fewer than 30% of the households in the franchise area subscribe to the cable system, or when an MVPD operated by the franchising authority offers service to at least 50% of the households in the franchise area.[22] The term "MVPD" is defined in the 1992 Act as "a person, such as, but not limited to, a cable operator, a multichannel multipoint distribution service ["MMDS"], a direct broadcast satellite ["DBS"] service, or a television receive-only ["TVRO"] satellite program distributor, who makes available for purchase, by subscribers or customers, multiple channels of video programming."[23]

10. As explained in Section III.A.4, *infra*, the competitive status of MVPDs is an appropriate starting point for this *Report*. However, Congress charged the Commission with annually reporting on the "status of competition in the market for the delivery of video programming."[24] In the Commission's view, obtaining a complete picture of the status of competition requires the Commission to look beyond MVPDs to other technologies not explicitly included within the statutory definition that may have a constraining effect on cable system practices.[25] Moreover, to fulfill its statutory mandate, the Commission believes it should also look beyond the "effective competition" standard of the 1992 Cable Act, which is

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[20] Communications Act § 623(a)(2), 47 U.S.C. § 543(a)(2).

[21] Communications Act § 623(l)(1), 47 U.S.C. § 543(l)(1).

[22] *Id.*

[23] Communications Act § 602(12), 47 U.S.C. § 522(12).

[24] Communications Act § 628(g), 47 U.S.C. § 548(g).

[25] *See infra* ¶¶ 46-53.

a bright-line test used to determine when a particular cable system's rates may be deregulated. Accordingly, in this *Report* and future reports, the Commission intends to provide a fuller economic analysis of the industry, rather than simply report on the status of "effective competition" in each franchise area in the country.

C. Summary of Findings

11. In this *Report*, the Commission makes the following findings:

12. Industry Growth. Between the end of 1990 and the end of 1993, cable industry subscriber penetration, average system channel capacity, the number of programming services available, cable industry revenues, expenditures on programming, and capital investment all increased. Data for the first half of 1994 that is available from companies that file reports with the Securities and Exchange Commission ("SEC"), while incomplete, suggest that subscribership and capital investment have increased for those companies from 1993 levels. In addition, ten of the fifteen largest cable system operators for which information is publicly-available, including the two largest such companies, have reported increases in cable service revenue for the first half of 1994, while the other five have reported decreased cable service revenues.

13. Cable Market Power. The market for the distribution of multichannel video programming remains heavily concentrated at the local level, and for most households, cable television is the only provider of multichannel video programming. Cable systems continue to have substantial market power at the local distribution level.

14. Horizontal Concentration. Since 1990, there has been a moderate increase in the horizontal concentration of cable multiple system operators ("MSOs") nationwide and, if consummated, several recent proposed mergers will result in increased "clustering" or regional concentration of cable system ownership.

15. Competitive Entry. There are presently only a few scattered areas of the country in which local cable systems face direct competition *via* "overbuilding" (where more than one cable system has cable lines passing the same homes). Providers using alternative video programming distribution media have not yet reached the subscribership levels necessary for the Commission to conclude that vigorous rivalry currently exists in the market for multichannel video programming distribution. However, alternative distribution media have made substantial strides since the *1990 Cable Report*. In particular:

- DBS service, merely a vision in 1990, is now operational, and is being rolled out around the country. It has been suggested that initial demand for the equipment necessary to receive DBS service has exceeded supply;

- MMDS or "wireless" cable systems are increasing in number, and are now obtaining the financial resources necessary for growth and expansion;

- Satellite Master Antenna Television ("SMATV") systems are growing in terms of numbers of systems and subscribers;

- in 1992, the Commission adopted a regulatory framework that permits companies providing local telephone service (commonly referred to as "local exchange carriers" or "LECs")[26] to construct and operate in their service territories common carrier platforms through which multiple entities can provide programming and other services to subscribers. Pursuant to that video dialtone ("VDT") framework, the Commission has authorized five technical or market trials and one permanent VDT service offering. In addition, there are twenty-three applications pending to provide permanent VDT service in other communities which, if granted, would allow service to 8.5 million homes; and

- other possible technological and regulatory advances have been identified that might allow broadcast television, low power television, Local Multipoint Distribution Service ("LMDS") and/or electric utilities to enter into the market for the distribution of multichannel video programming.

16. Vertical Integration. Vertical integration in the industry has remained at roughly the same level as in 1990, with cable MSOs continuing to invest in video programming vendors. The Commission anticipates that this investment will continue, and that the Commission's program access and program carriage rules will remain needed to guard against abuses that may result from such investment. Generally, those rules seem to have been successful in ensuring the availability of programming. Several firms that package programming for distribution to home satellite dish ("HSD") owners, however, have alleged that they continue to pay higher prices for programming than comparable cable operators.

[26] A glossary of technical terms and acronyms is included in Appendix B.

II.
CABLE INDUSTRY PERFORMANCE SINCE 1990

17. In this section of the *Report*, the Commission addresses the basic performance of firms that own or operate franchised cable systems.[27] This includes analysis of the following characteristics: (1) *output* -- the current amount of cable industry service that is being produced, and recent trends in that production; (2) *quality* -- the nature of the service, which is related to output since higher quality services are more highly valued and can, therefore, be thought of as more output; (3) *revenue* -- the income that is earned from the industry's output; (4) *expenditures and cash flow* -- the costs associated with the production of the industry's output; (5) *capital investment* -- the amount of investment by the companies in the industry; and (6) *transactions* -- the changes in ownership and trend towards consolidation in the industry. Section V of the *Report* contains a discussion of indicia of market power, including cable industry pricing, which is also an important indicator of industry performance.

A. Performance from 1990 to 1993

18. Cable Industry Output. Since the Commission last reported on the status of competition in this market in 1990,[28] the cable industry has continued to expand. The number of homes that could receive cable service ("homes passed") grew to 92.9 million in 1993 (up from 86 million in 1990), which was over 96% of all television households in the United States.[29]

19. With cable services available to more homes than ever before, the total number of households subscribing to basic cable services has increased to 57.4 million households, which is almost 60% of the television households in the United States (up from 51.7 million households and 55.8% of television households in 1990). The industry's penetration (which measures the percentage of households passed by cable that choose to subscribe to basic cable

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[27] As will be discussed in Section V.2, *infra,* industry performance, together with other factors, can be used to assess the extent of competition in the market. The *Report* contains data on the cable industry as a whole to the extent such information is available. As noted in the body of the *Report*, however, for certain information, particularly for the recent developments reported in Section II.B, data is only available for companies that make information publicly available, and should not be deemed to be necessarily representative of the entire industry.

[28] *1990 Cable Report*, 5 FCC Rcd 4962.

[29] *See* Appendix C, Table 1 (summarizing information, from, *inter alia, History of Cable & Pay TV Subscribers & Revenues*, CABLE TV INVESTOR, Mar. 31, 1994, at 9). Tables 2-10 referred to in this section are also included in Appendix C.

services) increased by 2.78% since the *1990 Cable Report*, so that nearly 62% of all households that could receive basic cable in 1993 purchased such services.[30]

20. Attributes of Cable Industry Service. The attributes or "quality" of cable services are multi-dimensional, and thus, no single measure of quality is available. Possible indices of cable service quality are the channel capacity of cable systems and the quantity of cable programming. Since 1990, average channel capacity has noticeably increased in the industry. Cable systems with the capacity for providing thirty or more channels accounted for over 77% of all cable systems for which information was available in 1993.[31] At the same time, systems that have capacities of twelve or fewer channels, which accounted for over 22% of all systems in 1987, accounted for only a little over 7% of all systems last year. As a result, by the end of 1993, nearly 97% of all subscribers for which information is available received service from systems that could provide at least thirty channels.[32]

21. Since the Commission issued the *1990 Cable Report,* there has also been noticeable growth in the number of cable programming choices. The number of basic programming networks grew by over 18%, from sixty-one at the end of 1990 to seventy-two at the end of 1993. The number of pay-per-view networks nearly doubled, from seven in 1990, to thirteen at the end of 1993. Overall, the number of programming networks increased by over 29%, from seventy-seven at the end of 1990, to ninety-nine at the end of 1993.[33]

22. Cable Industry Revenue. The cable industry continued to generate increased amounts of revenue between 1990 and 1993. It appears that the cable industry generated $22.94 billion in total revenue in 1993, which was over 28% more than the $17.86 billion it generated in 1990.[34] Of the 1993 amount, $13.55 billion, or over 59%, came from basic service tier programming.[35] Revenue from pay-per-view programming increased 102% from $253 million to $512 million over the same time period.

23. Advertising revenue has become an increasingly important source of revenue for the cable industry. Last year, cable operators' revenue from local and national spot

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[30] *Id.*

[31] *See* Appendix C, Table 2. The 77% of systems that can offer 30 or more channels represents a significant increase from the 67% figure in 1990.

[32] *See* Appendix C, Table 3.

[33] *See* Appendix C, Table 4.

[34] *See* Appendix C, Table 5.

[35] *Id.*

advertisement volume reached $1.064 billion,[36] up from $628 million in 1990.[37] Accordingly, advertising services provided cable systems with over 69% more revenue in 1993 than was the case in 1990.[38]

24. Cable Industry Expenditures and Earnings Before Interest, Taxes, Depreciation, and Amortization. Cable expenditures on programming rose by more than 25% between 1990 and 1993.[39] It appears that most of that increase came from substantial increases in expenditures for basic programming, which increased by 55% from $1.4 billion in 1990, to nearly $2.2 billion in 1993. Expenditures for other programming appear to have remained nearly constant over the same time period.[40]

25. Measurements of earnings before interest, taxes, depreciation, and amortization ("EBITDA"), which people in the industry commonly refer to as "cash flow," are often used to value the economic health of industry firms. It is difficult to generate such a measure for the cable industry as a whole because a significant percentage of subscribers are served by systems that do not publicly report financial information. Paul Kagan Associates, Inc. ("Kagan") has produced industry-wide cash flow estimates of $5 billion in 1987, $7.8 billion in 1990, and $10.1 billion last year.[41] For the purposes of this *Report*, the Commission has also produced an estimate of industry-wide cash flows for the same years.[42] Based on the

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[36] *Cable & Pay TV Subscribers & Revenues*, CABLE TV INVESTOR, Mar. 31, 1994, at 9; *see also* Kathy Healy, *Marketers Tune in to Cable's Appeal; Improvements Lead to Big Gains in Ad Spending*, ADVERTISING AGE, Feb. 28, 1994, at C-3 (reporting advertising revenues were greater than reported in CABLE TV INVESTOR).

[37] *See* Appendix C, Table 5.

[38] Expectations that cable networks will continue to draw large shares of the television audience were recently demonstrated by advertisers' upfront purchase of over $1 billion in commercial time from cable networks for the 1994-95 season, up 19% from last year's sales. Alan Breznick, *Advertising: Upfront '94 Wrapup*, CABLE WORLD, Aug. 29, 1994, at 40; Kent Gibbons, *Ratings Up, Cable '94 Ad Revenue Up 18%*, MULTICHANNEL NEWS, Sept. 12, 1994, at 16.

[39] *See* Appendix C, Table 6.

[40] *Id.*

[41] *See* PAUL KAGAN ASSOCS., INC., CABLE TV FINANCIAL DATABOOK ("1994 FINANCIAL DATABOOK") 88 (1994); PAUL KAGAN ASSOCS., INC., CABLE TV FINANCIAL DATABOOK ("1990 FINANCIAL DATABOOK") 118 (1990).

[42] The Commission arrived at its estimate of industry-wide cash flows by analyzing and extrapolating from the publicly-available information for fifteen of the largest cable industry MSOs. To the extent there are significant differences between the average financial

(continued...)

Commission's estimates, it appears that the industry generated cash flows of over $4.8 billion in 1987, $7.9 billion in 1990, and $10.5 billion in 1993.[43] It also appears that the industry had a cash flow per basic subscriber of $164.29 in 1993, which would represent an increase of 19% for the period between 1990 and 1993. Moreover, it appears that the industry's cash flow represented over 46% of its total revenue in 1993, which was a 4.4% increase over 1990.[44]

26. Capital Investment. In 1990, the industry invested nearly $3.0 billion in construction.[45] In 1991 and 1992, however, investment in construction dropped off, to approximately $2.2 billion in each of those years. The cable industry's construction investment rebounded in 1993, however, to almost the same level as in 1990, nearly $3.0 billion.[46]

27. Cable System Transactions. In 1990, systems with an aggregate value of $1.07 billion were sold, compared with the aggregate value of $11.21 billion for systems sold in 1987.[47] In 1993, however, the systems sold had an aggregate value of over eight billion dollars, even though the total number of transactions declined from 1990. The dollar value per subscriber of systems sold increased by over five percent during the same years, from $2049 in 1990, to $2160 in 1993.[48]

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[42](...continued)
performance of these large MSOs and that of smaller MSOs, those differences may affect the reliability of industry-wide estimates.

[43] *See* Appendix C, Table 7.

[44] *Id.* That 46% figure represents the industry's total cash flow divided by its total revenue, which is commonly referred to in the industry as "cash flow margin." It means that the industry had 46% of its total revenue on hand after accounting for operating expenses, but before accounting for interest, taxes, depreciation and amortization. Because the estimates for industry-wide cash flows are derived from the average cash flow margin for those larger MSOs that make such information publicly available, the degree to which the estimates are representative of the industry as a whole may be affected by any differences between the financial performance of smaller MSOs and that of larger MSOs.

[45] *See* 1994 FINANCIAL DATABOOK, *supra* note 41, at 92.

[46] *Id.*

[47] *See* Appendix C, Table 9.

[48] *Id.*

B. Recent Developments

28. In this section of the *Report*, the Commission provides data describing subscriber growth, revenue, capital investment and cable system transactions for the first half of 1994. The figures for subscriber growth, revenue and investment are taken from statements of cable system operators that publicly report such information in filings with the SEC. Those companies accounted for service to approximately fifty-five percent of all basic subscribers at the end of 1993, and they earned approximately fifty percent of all cable service revenue that year.[49] For many other MSOs, however, most of the relevant information is not publicly available, particularly in the case of privately-owned companies, which include most of the smaller MSOs.[50] Consequently, the information reported in the following discussion of recent developments is not necessarily representative of recent developments for the entire industry.

29. Subscriber Growth. The record indicates that the publicly-reporting companies have experienced continued growth in the number of basic subscribers over the first six months of 1994.[51] MSOs that have released reports this year that indicate recent subscriber growth include:

- the industry's largest MSO, TCI Communications, Inc. ("TCI"), which reported that it added 150,000 basic subscribers between the end of 1993 and March 31, 1994;[52]

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[49] *See* Appendix C, Table 7.

[50] The Commission has taken steps to lessen the impact of rate regulation on the revenues of small systems and operators. In particular, the Commission has created alternative regulatory approaches for small systems and operators that are designed to reduce the administrative burden associated with rate regulation, as well as the impact of the 17% percent rate reduction implemented in its March 30, 1994, order regarding rate regulation. *Implementation of Sections of the 1992 Cable Act: Rate Regulation, Second Order on Reconsideration, Fourth Report & Order, & Fifth Notice of Proposed Rulemaking* ("*1994 Rate Report & Order*") ¶¶ 117-135, 201-228, FCC 94-38 (MM Docket No. 92-266, Mar. 30, 1994).

[51] For discussions of possible explanations of the recent increase in subscriber growth, *see* Appendix I. *See also* John M. Higgins, *Re-Reg Credited for Helping Subs Gains*, MULTICHANNEL NEWS, Sept. 5, 1994, at 1

[52] Tele-Communications, Inc., *TCI Reports First Quarter Results* (Press Release May 16, 1994).

- Adelphia Communications Corporation ("Adelphia"), which reported that it had 1.37 million basic subscribers at the end of the second quarter of 1994, up 8.4% from the same time in 1993;[53]

- Cablevision Systems Corporation ("Cablevision"), which recently reported that the average number of subscribers it served in each of the first two quarters of 1994 was 9% greater than the average for the corresponding quarters of 1993;[54]

- Viacom Cable ("Viacom"), which reported that it "added 6,500 incremental basic customers in the second quarter of 1994, approximately 266% over the amount added in the second quarter of 1993," and that since June 30, 1993, its subscribers have grown 3%, to 1,117,000;[55]

- E.W. Scripps Company ("E.W. Scripps"), which reported that as of the end of the second quarter of 1994, it had 715,700 basic subscribers, up 5.1% from the prior year, and that its penetration rate increased from 59.9% to 61.9% in the same period;[56]

- various cable system partnerships managed by Jones Intercable, Inc. ("Jones Intercable"), which reported basic subscriber growth in the twelve months ended June 30, 1994, most in the 5-6% range;[57]

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[53] ADELPHIA COMMUNICATIONS CORP., FORM 10-Q 6 (June 30, 1994).

[54] CABLEVISION SYSTEMS CORP., FORM 10-Q 15 (June 30, 1994).

[55] VIACOM INC., FORM 10-Q 18 (June 30, 1994).

[56] E.W. SCRIPPS CO., FORM 10-Q 25 (June 30, 1994).

[57] *See* JONES CABLE INCOME FUND IC LTD., FORM 10-Q 9 (June 30, 1994) (increase of 6%, from 57,198 to 60,894 subscribers); JONES INTERCABLE INVESTORS LP, FORM 10-Q 9 (June 30, 1994) (6% increase, from 72,689 to 76,990); CABLE TV FUND 12A LTD., FORM 10-Q 9 (June 30, 1994) (increase of 5%, from 63,715 to 67,103 subscribers); CABLE TV FUND 12B LTD., FORM 10-Q 10 (June 30, 1994) (increase of 2%, from 63,825 to 64,933 subscribers); CABLE TV FUND 12C LTD., FORM 10-Q 10 (June 30, 1994) (increase of 5%, from 208,474 to 219,403 subscribers); CABLE TV FUND 12D LTD., FORM 10-Q 9 (June 30, 1994) (increase of 5%, from 208,474 to 219,403 subscribers); CABLE TV FUND 14A LTD., FORM 10-Q 11-12 (June 30, 1994) (subscribers in wholly-owned systems up 6%, from 88,657 to 93,978; in non-wholly owned system, subscribers up 5%, from 43,082 to 54,324); CABLE TV FUND 14B LTD., FORM 10-Q 12 (June 30, 1994) (subscribers in wholly-owned systems up 5%, from 22,718 to 23,864).

- Cablevision Industries Corporation ("CVI") reported that it now serves 977,000 subscribers, and added 35,000 basic subscribers in the past year from internal growth of systems, in spite of the Los Angeles earthquake in January, which resulted in a loss of 5000 subscribers;[58]

- Century Communications Corporation ("Century"), whose recent annual report states that the number of subscribers it serves increased 2.4% from 919,000 on May 31, 1993, to 941,200 on May 31, 1994;[59] and

- Times Mirror Company ("Times Mirror"), which stated in its last quarterly report that specifically discussed its cable television operations that it experienced 3% internal basic subscriber growth between March 1993 and March 1994.[60]

30. Revenues. Information from cable system operators that make financial information publicly-available through the SEC indicates that cable systems revenues have remained relatively steady through the first six months of 1994. According to the most recent annual or quarterly reports of fifteen cable system operators, ten reported increased cable system revenues and five reported decreases.[61] For example:

- TCI reported an overall 4% revenue increase for the first half of 1994, compared to the corresponding six-month period in 1993. According to its second quarter report, the increase in revenue that resulted from an increased number of subscribers exceeded the decrease in revenue that resulted from rate regulation;[62]

- Time Warner Cable ("Time Warner") reported slightly increased revenues for the first six months of 1994, stating that, "the

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[58] CABLEVISION INDUSTRIES CORP., FORM 10-Q 11 (June 30, 1994).

[59] CENTURY COMMUNICATIONS CORP., FORM 10-K 31 (May 31, 1994).

[60] TIMES MIRROR CO., FORM 10-Q 11 (March 27, 1994).

[61] Those fifteen cable system operators are Adelphia, Cablevision, CVI, Century, Comcast, E.W. Scripps, Falcon Cable Systems Co. ("Falcon Cable"), Falcon Classic Cable Income Properties, L.P. ("Falcon Classic"), Multimedia Inc. ("Multimedia"), TCA Cable TV, Inc. ("TCA"), TCI, Time Warner Cable ("Time Warner"), Times Mirror, Viacom and The Washington Post Co.

[62] TCI COMMUNICATIONS, INC., FORM 10-Q I-21 (June 30, 1994).

unfavorable effects of rate regulation were offset in part by an increase in subscribers and unregulated revenues;"[63]

- Cablevision reported a 13% increase in its net revenues for the first six months of 1994, compared to 1993, most of which it attributed to a nine-percent internal growth in its number of basic subscribers;[64] and

- Adelphia reported that "[r]evenues increased approximately 5.5% for the three months ended June 30, 1994, compared to the same period in the prior year. Approximately 86% of such increases were attributable to basic subscriber growth, with the remainder primarily attributable to the expansion of advertising sales and other services."[65]

CVI, Century, Falcon Classic, Multimedia, TCA and Times Mirror also reported increased revenues.[66]

31. On the other hand, several MSOs reported decreases in revenues during the first six months of 1994. Comcast's service income for its cable division was down nearly $24 million in the first half of 1994, as compared to the first half of 1993.[67] E.W. Scripps reported that its revenues from basic service in the second quarter of 1994 were down 6.3%

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[63] TIME WARNER INC., FORM 10-Q 7 (June 30, 1994).

[64] CABLEVISION SYSTEMS INC., FORM 10-Q 14 (June 30, 1994).

[65] ADELPHIA COMMUNICATIONS CORP., FORM 10-Q 7 (June 30, 1994).

[66] CABLEVISION INDUSTRIES CORP., FORM 10-Q 3, 11 (June 30, 1994) (revenues in first half of 1994 up 1.9% over first half of 1993, "attributable principally to internal subscriber growth" and other sources); CENTURY COMMUNICATIONS CORP., FORM 10-K 31 (May 31, 1994) (cable television operation revenues increased 5.4% in fiscal year ended May 31, 1994, attributed to "increases in the number of cable television subscriptions and in the subscriber revenues for cable television services"); FALCON CLASSIC CABLE INCOME PROPERTIES, L.P., FORM 10-Q 4, 7 (June 30, 1994) (revenues in first half of 1994 up 6.8% over first half of 1993; 52% due to increase in the number of subscribers); MULTIMEDIA INC., FORM 10-Q 2 (June 30, 1994) (revenues up 1%); TCA CABLE TV, INC., FORM 10-Q 9 (July 31, 1994) (third quarter revenues up 7% over last year, "mostly attributable to internal growth"); TIMES MIRROR CO., FORM 10-Q 11 (May 27, 1994) (cable revenues up 8.6% over last year due to continued subscriber growth and other revenues).

[67] COMCAST CORP., FORM 10-Q 9 (June 30, 1994).

from the same period of 1993, despite a 5.1% increase in basic subscribers.[68] Viacom's cable revenues decreased 4% in the second quarter of 1994, including $6 million in revenue losses from the mandated rate decreases.[69] Falcon Cable and The Washington Post Company each reported cable revenue decreases of approximately 1%.[70]

32. Capital Investment. The cable industry also appears to be substantially increasing its capital investment in infrastructure development. Kagan projects that the industry will invest nearly $3.8 billion in construction this year, which is a twenty-eight percent increase over the amount invested in construction in 1993.[71] TCI alone has a capital budget of $1 billion for 1994 "for the continued rebuilding of its cable systems."[72]

33. In February, Multimedia announced a $150 million upgrade of its cable operations over the next five years, which will include spending $45 million in both 1994 and 1995 to replace coaxial wire with fiber.[73] Century increased its budget for capital expenditures in its cable operations by twenty-three percent over fiscal year 1993, from approximately $37.4 million to $46.1 million.[74] Century plans to "expand the operations of certain cable television systems into adjacent and previously unbuilt areas," as well as to upgrade its existing cable plant.[75] CVI's most recent quarterly report stated that the company plans to spend $68 million in 1994 for purposes such as expanding channel capacity, deploying fiber optic technology, and increasing the number of addressable converters.[76]

34. Time Warner has reported that it will spend $750 million this year on cable capital investment, more than twice its 1993 cable capital outlays of $353 million.[77] Time Warner also reported earlier this year, however, that the $750 million represented a reduction

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[68] E.W. SCRIPPS CO., FORM 10-Q F-21 (June 30, 1994). E.W. Scripps also reported that its cable operating income was down 36.6% in the same period. *Id.*

[69] VIACOM INC., FORM 10-Q 18 (June 30, 1994).

[70] FALCON CABLE SYSTEMS CO., FORM 10-Q 3-4 (June 30, 1994); THE WASHINGTON POST CO., FORM 10-Q 8 (June 30, 1994).

[71] 1994 FINANCIAL DATABOOK 88.

[72] TCI COMMUNICATIONS, INC., FORM 10-Q I-19 (June 30, 1994).

[73] MULTIMEDIA INC., FORM 10-Q 2 (June 30, 1994).

[74] CENTURY COMMUNICATIONS CORP., FORM 10-K 75 (May 31, 1994).

[75] *Id.* at 35.

[76] CABLEVISION INDUSTRIES CORP., FORM 10-Q 12 (June 30, 1994).

[77] Mark Robichaux, *Time Warner Trims Cable-TV Budget Due to Rate Cuts*, WALL ST. J., May 5, 1994, at B-7; *see also* TIME WARNER INC., FORM 10-Q 11 (June 30, 1994).

of $100 million from the amount that had been budgeted for 1994, due to rate reductions mandated by the Commission.[78] E.W. Scripps spent 40.8% less on cable capital expenditures in the second quarter of 1994, and 30.7% less in the first half of 1994, as compared to the same periods in 1993, even though it now serves 5.1% more subscribers than in 1993.[79]

35. Leading suppliers of cable hardware have reported substantial increases in sales this year. In particular, General Instrument Corp. ("GI") reports that its sales are up by over 64% for the first half of this year, and that its second quarter sales were 24% higher than its first quarter sales. Moreover, recent reports indicate GI's production of cable converter boxes has doubled from 9000 to 18,000 units per day, and GI is reported to attribute its increased sales to "increased cable television operator infrastructure spending . . . ."[80]

36. Cable System Transactions. There has been considerable activity in the market for cable system transactions during 1994.[81] The thirty-eight transactions announced in 1994 that have been identified by the Commission have a total dollar value of nearly $10.95 billion which, if the transactions are consummated, would be significantly greater than the $8.32 billion that changed hands in 1993.[82] However, the average price of $2035 per subscriber and cash flow multiple of 10.2 times cash flow are somewhat lower this year than the 1993 levels of $2160 per subscriber and 11.3 times cash flow.[83] Among the major proposed transactions that have been announced in 1994, are the following transactions involving four of the five largest MSOs:[84]

- the proposed acquisition by Comcast Cable of systems that Rogers Communications purchased from Maclean Hunter. The Rogers systems that are being purchased serve a total of 547,000 subscribers, and are being purchased for $1.27 billion;

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[78] *Id.*

[79] E.W. SCRIPPS CO., FORM 10-Q F-21 (June 30, 1994).

[80] Carl Weinschenk, *The State of GI*, CABLE WORLD, Sept. 5, 1994, at 27; GENERAL INSTRUMENT CORP., FORM 10-Q 17 (June 30, 1994).

[81] Appendix C, Table 10, lists cable system transactions announced in 1994 that have been identified by the Commission.

[82] Because dollar values for the proposed transaction between Time Warner and Newhouse Broadcasting Corp. are difficult to estimate, in large part due to the fact that a joint venture will be formed, that transaction is not included in the $10.95 billion figure for the total dollar value of transactions this year. *Time Warner to Put Some Cable Systems into Venture with Newhouse Operations*, WALL ST. J., Sept. 13, 1994, at A2.

[83] *Compare id. with* Appendix C, Table 9.

[84] *See* Appendix C, Table 10.

- the proposed acquisition by Cox Cable Communications of cable systems owned by Times Mirror serving 1.2 million subscribers, for a purchase price of $2.29 billion;

- the proposed acquisition by TCI of systems owned by Tele-Cable Corp. serving 740,000 subscribers, for a purchase price of $1.5 billion; and

- the proposed merger of certain cable systems owned by Time Warner, which serve 2.8 million subscribers, into a joint venture with cable systems owned by Newhouse Broadcasting Corp. and Advanced Publications, Inc., which serve 1.4 million subscribers. The cable systems being contributed to the proposed joint venture have been valued at $8.4 billion.

III.
STATUS OF EXISTING AND POTENTIAL COMPETITORS TO FRANCHISED CABLE SYSTEMS

A. Market Definition

37. In this section of the *Report*, the Commission first discusses the relevant market concept and how it has been applied to the cable television industry by the Commission and Congress over time. Parts B and C of this section contain discussions of various other distribution media that offer, or could offer, services that, to different degrees, may have the potential to constrain cable industry conduct.

1. The Relevant Market Concept

38. Defining the "relevant market," a concept drawn from antitrust law, is an important first step in assessing whether a firm has market power, *i.e.*, "the power to control market prices and exclude competition."[85] The relevant market has both geographic and product components, which, when defined, allow for the identification of market participants and their respective market shares.[86]

39. For the purposes of this *Report*, the Commission draws upon the relevant market concept in order to identify those distribution technologies that will potentially have a constraining effect on cable operator conduct. Therefore, as part of this and future reports, the Commission will report on the basic conditions relative to those industries, including the extent of their competition with cable operators.

40. Antitrust case law and economic theory define the relevant product market by analyzing the degree to which products or services are "reasonably interchangeable by consumers for the same purposes."[87] The geographic market is defined in a similar manner. The geographic market is the area in which products compete with substantial parity.[88] As

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[85] *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 391 (1956).

[86] *See Policy & Rules Concerning Rates for Competitive Common Carrier Services & Facilities Authorizations Therefor, Fourth Report & Order* ¶ 67, 95 FCC 2d 554, 562-63 (1983) (*"Competitive Common Carrier Report & Order")*.

[87] *du Pont,* 351 U.S. at 394 (1956). The use of "cross-elasticity" of demand in the process of defining a product market has received support by antitrust law commentators, economists, the Department of Justice, and courts. *See, e.g.*, William M. Landes & Richard A. Posner, *Market Power in Antitrust Cases*, 94 HARV. L. REV. 937, 945-48 (1981); George S. Stigler & Sherwin Rosen, *The Extent of the Market*, 28 J. L. & ECON. 555 (1985).

[88] *See, e.g., Satellite Television & Associated Resources, Inc. v. Continental Cablevision, Inc.*, 714 F.2d 351, 356 (4th Cir. 1983), *cert. denied*, 465 U.S. 1027 (1984).

with the definition of the relevant product market, its scope is defined by the geographic area to which buyers can reasonably turn or from which competing suppliers are likely to sell.[89]

2. *The Commission's Evolving Approach to Market Definition for Cable Services*

41. In the mid-1980s, the Commission's view of the relevant market was shaped by its implementation of the 1984 Cable Act,[90] which exempted cable systems from rate regulation unless the cable system was not subject to "effective competition" under a definition to be determined by the Commission.[91] In 1985, the Commission adopted rules that deemed "effective competition" to exist if at least three unduplicated broadcast television signals were "available" to the cable community.[92] The Commission thus concluded that three broadcast stations were sufficient to constrain monopolistic pricing of basic cable services, and defined a relevant market that included (though was not necessarily limited to) those two media.[93]

42. The Commission's view of the relevant market in which cable operators compete has evolved considerably since the *1985 Effective Competition Report & Order*. The Commission initiated a rulemaking in 1990 regarding the effective competition standard it had adopted five years earlier,[94] and later issued the *1990 Cable Report*.[95] In the *1990 Cable Report*, the Commission examined the services cable systems provided to consumers in a

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[89] *Tampa Elec. Co. v. Nashville Coal Co.* ("*Tampa Electric*"), 365 U.S. 320, 330-33 (1961).

[90] Pub. L. No. 98-549, 98 Stat. 2779 (1984).

[91] 1984 Cable Act, sec. 2, § 623(b)(1), 98 Stat. at 2788.

[92] 47 C.F.R. § 76.33(a) (1988) (superseded). Those rules were upheld in *ACLU v. FCC*, 823 F.2d 1554, 1564-70 (D.C. Cir. 1987), *cert. denied sub nom.*, *Connecticut v. FCC*, 485 U.S. 959 (1988).

[93] The Commission based this rule on evidence that cable systems would be able to exercise market power when the share of viewership of all "cable-only" programming was as large or larger than the viewership of an over-the-air broadcast station. The Commission found that this occurred when less than three over-the-air broadcast stations were available. *Amendment of Parts 1, 63 & 76 of the Commission's Rules to Implement the Provisions of the Cable Communications Policy Act of 1984, Report & Order ("1985 Effective Competition Report & Order")* ¶ 100, 50 Fed. Reg. 18,637, 18,650 (1985).

[94] *Reexamination of the Effective Competition Standard for the Regulation of Cable Television Basic Service Rates, Notice of Proposed Rule Making,* ("*1990 Notice*"), 5 FCC Rcd 259 (1990).

[95] *1990 Cable Report*, 5 FCC Rcd 4962.

detailed manner. The Commission concluded that cable systems provide four distinct services: "antenna service" (retransmission of broadcast signals), "premium" programming (*e.g.*, HBO, Cinemax), "general interest basic channels similar to independent television stations" (*e.g.*, USA, TNT), and "specialized basic services" (*e.g.*, ESPN, CNN, MTV, BET).[96] Examining the "substitutability" of other media for each of these services, the Commission found that video cassette recorders ("VCRs") and video cassettes were good substitutes for premium services, and that local broadcast stations were good substitutes for the "antenna service."[97] The Commission then proceeded to find evidence of market power in the remaining services.[98]

43. The Commission recognized in the *1990 Cable Report* that broadcasters offer some competition to cable systems, and "can be a significant constraint on basic cable rates."[99] The Commission found, however, that "there is no close substitute for that steadily-expanding complement of specialized program services offered by the typical cable system at this time."[100] The Commission also expressly rejected defining the market as "information and leisure entertainment services" (which would include radio, print media, movie, legitimate theater and live events as alternatives).[101] As to the geographic market, the Commission concluded that the relevant market was essentially local in scope, noting that "because most cable systems operate under a local franchise, that describes the area within which they are entitled to distribute video services."[102]

44. In a concurrent rulemaking proceeding, the Commission reexamined the "three over-the-air signals" test for effective competition adopted in 1985.[103] When it sought comments in that proceeding, the Commission stated that it had replicated its prior research (which concluded that three-over-the-air broadcast signals could constrain basic cable rates),

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[96] *Id.* ¶ 50, 5 FCC Rcd at 4995.

[97] *Id.*

[98] *Id.* ¶¶ 69-70, 5 FCC Rcd at 5003.

[99] *Id.* ¶ 66, 5 FCC Rcd at 5002.

[100] *Id.* ¶ 13(2), 5 FCC Rcd at 4972.

[101] *Id.* ¶ 53, 5 FCC Rcd at 4996-97.

[102] *Id.* ¶ 48, 5 FCC Rcd at 4994.

[103] *Reexamination of the Effective Competition Standard for the Regulation of Cable Television Basic Service Rates, Report & Order & Second Further Notice of Proposed Rule Making ("1991 Effective Competition Report & Order")*, 6 FCC Rcd 4545 (1991).

and found that its conclusions were no longer applicable to consumer demand in 1990.[104] The Commission noted that "a small number of broadcast signals alone generally cannot deliver comparable service" to basic cable.[105] On the other hand, in the *1991 Effective Competition Report & Order*, the Commission found that if enough signals were available, broadcast television could have some constraining effect on basic cable pricing. Utilizing new econometric data, the Commission determined that six unduplicated over-the-air broadcast television stations were needed to constrain monopolistic pricing or conduct in basic services.[106]

45. In 1991, the Commission also adopted a "multichannel competitor test" that recognized competition from alternative suppliers of delivered multichannel video services by creating a "50/10" test (50% availability of alternative sources with 10% total subscribership to those alternative sources).[107] The Commission reasoned that even though alternative suppliers might offer different channel packages, "these alternatives should be considered substitutes for basic cable service since they provide a variety of programming services . . . ."[108]

3. *The 1992 Cable Act*

46. The 1992 Cable Act, in part, uses a conceptual view of the relevant market similar to that outlined in the *1990 Cable Report* to define the circumstances when cable rates will be exempt from rate regulation. It provides that a cable system will be subject to rate regulation unless the cable system is subject to "effective competition," a determination which is to be made through the use of a two-part test.[109]

47. First, the 1992 Cable Act identifies the types of services that are capable of constraining cable system pricing. Each such service is referred to as a "multichannel video programming distributor" ("MVPD"), and is defined as "a person . . . who makes available

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[104] *Reexamination of the Effective Competition Standard for the Regulation of Cable Television Basic Service Rates, Further Notice of Proposed Rule Making* ("*1990 Further Notice*"), 6 FCC Rcd 208 (1990).

[105] *1990 Further Notice* ¶ 5, 6 FCC Rcd at 208-09.

[106] *1991 Effective Competition Report & Order* ¶¶ 9-29, 6 FCC Rcd at 4547-51. As discussed *infra* at ¶ 191, in connection with its 1994 Rate proceeding, the Commission found evidence consistent with a finding that broadcast stations do not constrain cable rates.

[107] *Id.* ¶ 37, 6 FCC Rcd at 4552-53.

[108] *Id.*

[109] Communications Act § 623(a)(2), 47 U.S.C. § 543(a)(2).

for purchase, by subscribers or customers, multiple channels of video programming."[110] Thus, the 1992 Cable Act explicitly contemplates a relevant product market comprised of distributors that offer multichannel video programming on a subscription basis.

48. Second, the 1992 Cable Act requires determination, on a franchise-area by franchise-area basis, of when "effective competition" is deemed to exist by reference to the actual presence of MVPDs providing service in a particular locale.[111] Specifically, effective competition exists under the 1992 Act where the franchise area is served by at least two MVPDs, each of which "offers comparable video programming" to at least 50% of the households, and at least 15% of the households "subscrib[e]" to the smaller MVPD.[112] The 1992 Act provides for consideration of only those firms that have actually entered the market and are providing service in determining whether cable rates in a particular franchise area should be deregulated. The 1992 Act also contains a penetration test, whereby effective competition is deemed to exist if "fewer than 30 percent of the households in the franchise area subscribe to cable service of the cable system."[113] In addition, effective competition is

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[110] Communications Act § 602(12), 47 U.S.C. § 522(12).

[111] Before a local franchising authority ("franchisor") may regulate basic cable rates, it must be certified by the Commission under Section 623(a) of the Communications Act. 47 U.S.C. § 543(a); 47 C.F.R. § 76.906. The Commission's standards for such certification are set forth in Section 543(a)(3) of the Communications Act, 47 U.S.C. § 543(a)(3), and concern the franchisor's legal authority to regulate, the consistency of its regulations with those of the Commission, and whether its procedures are reasonable and open to all interested parties. In certification proceedings, "effective competition" is presumed not to exist in the jurisdiction in question. 47 C.F.R. § 76.906. An intervenor (typically, the local cable operator) may, however, establish that effective competition *does* exist and thus defeat rate regulation by the franchisor. 47 C.F.R. § 76.911(b).

[112] Communications Act § 623(l)(1)(B), 47 U.S.C. § 543(l)(1)(B). The Commission has adopted a two-part test for determining whether consumers are "served" by two MVPDs: each MVPD's service must both be both technically available and actually available to cable subscribers. *Implementation of Sections of the 1992 Cable Act -- Rate Regulation, Report & Order Further Notice of Proposed Rulemaking ("1993 Rate Report & Order")* ¶ 38, 8 FCC Rcd 5631, 5666 (1993). An MVPD's service is considered comparable if it provides at least 12 channels "including at least one channel of nonbroadcast service programming." *Id.* For purposes of determining when the 15% threshold is reached, the subscriberships of all alternative MVPDs serving at least 50% of the households in the franchise area are aggregated. *Id.* at 5662-65.

[113] Communications Act § 623(l)(1)(A), 47 U.S.C. § 543(l)(1)(A).