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Before the  
FEDERAL COMMUNICATIONS COMMISSION FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554 OFFICE OF SECRETARY

In the Matter of )  
)  
Implementation of Section 302 of )  
the Telecommunications Act of 1996 )  
)  
Open Video Systems )

CS Docket No. 96-46

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In the Matter of )  
)  
Telephone Company-Cable )  
Television Cross-Ownership Rules, )  
Sections 63.54-63.58 )  
)

CC Docket No. 87-266 (Terminated)

**REPLY COMMENTS**  
**OF THE NATIONAL CABLE TELEVISION ASSOCIATION, INC.**

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**REPLY COMMENTS OF  
THE NATIONAL CABLE TELEVISION ASSOCIATION, INC.**

The National Cable Television Association, Inc., by its attorneys, submits the following  
“Reply Comments” in response to the comments submitted in the above-captioned proceeding.

**INTRODUCTION AND SUMMARY**

The Telecommunications Act offers telephone companies, incumbent cable operators  
and others an alternative to the traditional cable model under which they may offer cable-  
equivalent service without obtaining a local franchise in exchange for ceding up to two-thirds of  
the available channel capacity to unaffiliated packagers/programmers. In its Comments, NCTA  
called upon the Commission to adopt rules that fairly balance the twin policy goals of providing  
nondiscriminatory access to programmers and of promoting competition to incumbent cable  
systems by eliminating the franchise requirement. In contrast, telephone company comments

ask the Commission to tilt its ruling strongly toward regulations that inhibit intra-modal competition.

Simply put, the telcos want de facto editorial control over the same number of channels as cable operators, but they resist the local franchise responsibilities of cable operators. That is not what Congress had in mind. Rather, the statute contemplates different packagers able to obtain capacity on a nondiscriminatory basis. The OVS regulations must enforce nondiscriminatory access.

Following review of the comments of other parties, we again urge the Commission:

- To adopt effective cost allocation procedures;
- To adopt a separate subsidiary to facilitate the detection of discrimination and cross-subsidy;
- So long as channel capacity is scarce, to limit the number of channels that an OVS operator may select to one-third of the activated channels, exclusive of must carry and PEG requirements, but including the shared channels;
- To establish procedures that guarantee programmers nondiscriminatory access to OVS system facilities;
- To mandate procedures that prevent discrimination against unaffiliated programmers in the provision of information to subscribers;
- To provide for selection of the channel administrator based upon the collective determination of the programmers using capacity on the system, and to provide for the classification of channels, exclusive of must carry and PEG channels, as “shared” only when programmers enter into agreements for the simultaneous carriage of a program network on the facility;
- To prohibit, until effective telephone service competition is a reality, the joint marketing of telephone service and telephone company-provided OVS transmission or programming services, unless customers are simultaneously made aware of video transmission and programming alternatives by cable operators, in a manner that gives no advantage to OVS over competing cable operators or unaffiliated packagers/programmers;

- To permit incumbent cable operators the same choice as is available to incumbent LECs to provide OVS service in lieu of franchised cable service; and
- To require a demonstration of compliance with Commission policies, regulations and procedures, including cost allocations, prior to certification, and to further require ongoing compliance following certification.

We urge action on each of these items to bring about an OVS scheme that affords unaffiliated programmers a real competitive opportunity.

**I. NONDISCRIMINATORY ACCESS FOR PROGRAMMERS IS ABSOLUTELY ESSENTIAL**

NCTA's comments emphasized that the unequivocal obligation to provide nondiscriminatory access to unaffiliated packager/programmers distinguishes OVS from traditional cable service. In contrast to traditional cable system arrangements in which the cable operator exercises substantial editorial control, OVS contemplates that the facility provider will cede control of up to two-thirds of the activated channels to competitors. It is only because two-thirds of the available channels are made available to the operator's competitors that Congress agreed to give the OVS operator the competitive edge of no local franchise obligations.

LECs filing comments in this proceeding urge the Commission to vitiate this arrangement, asking that OVS be operated on an essentially unregulated basis. Despite the express requirement in the statute that OVS operators offer unaffiliated programmers nondiscriminatory access on up to two-thirds of the activated capacity, LECs offer up rationales for defeating the statute's requirement.<sup>1</sup>

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<sup>1</sup> NYNEX's Comments are particularly troubling in this regard. See Comments of NYNEX, Apr. 1, 1996, at 9-14. In response to the statute's absolute requirement that OVS operators offer nonaffiliates nondiscriminatory access, NYNEX conjures up a series of rationales that, if accepted, will vitiate nondiscriminatory access. NYNEX goes so far as to argue that "OVS operators should...be permitted to preclude the use of the system for the distribution of programs or program series by an entity with exclusive rights to the program or favorable contract terms that effectively preclude others from

**A. Channel Counting and Channel Sharing**

**1. Counting Must Carry and PEG Channels**

In its comments, NCTA endorsed the Commission's proposal to take the "must carry" and PEG channels "off the top," entitling OVS operators to one-third of the remaining channels. The Commission's example proposed that if there are 90 activated channels, and 15 stations are entitled to must carry status, the number of must carry stations will be subtracted from the total (i.e., 90 minus 15), leaving 75 channels. Of these, the OVS operator will be entitled to one-third. This proposal has the advantage of requiring the OVS operator (and other programmers) to "contribute" channel slots to the must carry "pool" in proportion to the number of channels which they are guaranteed.

The telephone parties object to this arrangement. The joint filing of six telephone companies, for example, hereafter referred to as Joint Telephone Parties,<sup>2</sup> argues that the Commission is incorrect when it proposes "to deduct...[the must carry and PEG] channels from the total prior to calculating the operator's one-third."<sup>3</sup> The Joint Telephone Parties maintain that "This approach violates Section 653, which unambiguously bases the operator's one-third on the 'activated channel capacity.'"<sup>4</sup> They reason that "activated channel capacity" is defined

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distributing the program on that open video system." NYNEX Comments at 12. The consequence of adopting this proposal would be to permit NYNEX and other OVS operators to arrange for exclusivity on their affiliate's channels, but to prevent the carriage by unaffiliated packagers of individual programs or program series for which they have negotiated exclusivity. The Commission should reject this plainly anticompetitive proposal.

<sup>2</sup> The Joint Telephone Parties include Bell Atlantic, BellSouth, GTE, Lincoln Telephone, Pacific Bell and SBC Communications.

<sup>3</sup> Comments of Joint Telephone Parties, Apr. 1, 1996, at 13.

<sup>4</sup> Id.

in Title VI as those channels engineered at the headend, including PEG channels, generally available to a cable system's residential subscribers. They claim that because PEG channels are among the "activated" channels, channels used for PEG and must carry should not be included among the one-third of channels to which the OVS operator is entitled.

The Joint Telephone Parties are wrong. The Commission is well within its discretion to require that the OVS operator count a portion (or indeed all) of the must carry and PEG stations as part of the one-third of channels to which the OVS operator is entitled. Since the OVS operator is carrying these channels, it is proper to include them within the one-third limitation. It is also reasonable, however, for the Commission to employ its discretion to require all of the system's programmers to share the obligation for carriage of must carry and PEG stations. For that reason, in our comments we endorsed on policy grounds taking the must carry/PEG stations "off the top," an arrangement which shares the obligation of must carry/PEG carriage.

Adopting the Joint Telephone Parties proposal would have draconian consequences. Using the Commission's example, under their proposal the OVS operator's 30 channels would be first subtracted from the total activated channels (90 minus 30, equals 60). Thereafter, the 15 must carry channels would be taken. At that point, 45 channels would be available for division among all of the other programmers in competition with the OVS operator's package. This contrasts to the Commission's more equitable proposal under which the OVS operator receives 25 channels, and 50 are available for competitors. The net result is that under the Commission's proposal two times as many channels are available to competitors as to the OVS operator, while under the LECs' plan only one and one-half times as many channels are available to competitors as to the OVS operator.

## 2. Shared Channels

NCTA's comments contended that when an OVS operator chooses a channel that is to be shared with other programmers, it "selects" that channel. It follows that shared channels should be included as part of the one-third of channels for which OVS operators are entitled to "select" the programming.

LECs seek an even greater advantage. U S WEST, for example, argues that "only programming that is the subject of a unilateral decision by the OVS operator or its affiliate should be classified as programming that is 'selected' by the OVS operator. Any other interpretation would constrain an OVS operator's selection rights beyond the statutory one-third limit."<sup>5</sup> U S WEST further contends that by sharing a channel it is not "selecting" programming for purposes of Section 653 (b)(1)(B). Rather, in that circumstance the OVS operator has "only required that it be delivered in the most efficient manner, as the law allows."<sup>6</sup>

U S WEST's reasoning is unavailing. If the OVS operator is merely delivering a shared channel included within its package, rather than "selecting" the particular channel, how does the channel get on the system? How, for example, does C-SPAN I as opposed to C-SPAN II get on a shared channel unless the OVS operator's programming entity (along with other packagers) "select" C-SPAN I and decide not to "select" C-SPAN II? Channel selection, whether on an exclusive or shared basis, is the very essence of editorial activity that the packager undertakes when it selects one channel, and decides not to select another. So long as the OVS operator's

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<sup>5</sup> U S WEST, Inc. Comments on Open Video Systems, Apr. 1, 1996, at 16 ("U S WEST Comments").

<sup>6</sup> Id.

programming arm undertakes the editorial function, it is engaged in program selection rather than the mere delivery of a transmission “in the most efficient manner.”

Practically speaking, acceptance of the LEC proposal will have seriously detrimental consequences for intra-modal competition. Returning to the Commission’s 90-channel example, if there are 15 must carry and PEG stations, 30 channels reserved exclusively for the OVS operator, and 25 shared channels, only 20 channels would remain for competitors. Even if only one unaffiliated packager sought capacity (and several are likely), the competitor would have only 20 exclusive channels in comparison to 30 for the OVS operator. The Act does not contemplate placing the OVS operator’s customer-competitors at such a severe disadvantage. To the contrary, the Act directs that competitors will obtain access to the OVS operator on a nondiscriminatory basis. The Commission should reject the LECs’ proposals because, if they are adopted, discrimination is unavoidable.

#### **B. Channel Administration**

In its comments, NCTA proposed the sharing of the channel administrator function among the programmers on the system. By providing for the sharing of administration functions, the Commission can be more assured that the OVS operator’s programming entity does not use the role as channel administrator to discriminate against competing packagers. NCTA specifically pointed out that by calling for the joint administration of shared channels we were not advocating the establishment of new bureaucracies in every location. Rather, NCTA anticipates that each programmer using the system would designate an employee to attend a necessary joint meeting or meetings.

The LECs want the exclusive responsibility to administer the must carry and shared channels. The Joint Telephone Parties maintain “any other conclusion would be fundamentally inconsistent with Section 653 and patently absurd.”<sup>7</sup>

They surely recognize, however, that if telcos are permitted to exclusively perform the channel administration functions, their already considerable competitive advantages will be even further enhanced. They will, for example, be able to decide the means by which must carry, PEG and shared channels are made available to their competitors. If combined with other advantages, competition will be compromised even further.

The prospects for the “level playing field” contemplated for programmers on the OVS facility will be considerably enhanced if the Commission adopts joint channel administration. If all of the programmers have an opportunity to share in the channel administration decisions, consumers are much more likely to obtain real choices among program providers. Nothing in Section 653 prohibits this arrangement, and competitive considerations call for it.

**C. Channel Positioning**

NCTA’s comments called for delegating the channel positioning function to the joint channel administrator. Our comments recognized that it may be appropriate to assign the lower channel numbers to the must carry and shared channels, in recognition of the presumed superior popularity of these stations.

The LECs contend that the OVS operator should be entitled to determine channel positions on its own. The Joint Telephone Parties, for example, contend that operators must be

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<sup>7</sup> Joint Telephone Parties at 11.

permitted to assign channel positions.<sup>8</sup> But this result would enable the OVS operator to further disadvantage its competitors.

For example, an OVS operator might place its exclusive channels on the most desirable low channel numbers, while leaving the highest numbers for competitors. That result would be directly contrary to the principle of providing nondiscriminatory access to programmers. Under the proposal of the Joint Telephone Parties, competitors dissatisfied with an OVS operator's decision on channel positioning would bear the burden of proof. They would have to fight it out with the OVS operator in an individual adjudication in which the operator would argue that the competitor had not met the "unjust or unreasonable" standard. The wiser course -- and the one most consistent with the competition policy goal of the statute -- is to decide at the outset to eliminate the possibility of discriminatory channel positioning by adopting joint determination of channel positions.

**D. Maximum/Minimum Capacity Limits**

While the statute clearly limits the OVS operator to one-third of system capacity in situations where demand for channel slots exceeds the supply of available activated channels (the OVS operator's programming entity may occupy whatever portion of the remaining two-thirds of the capacity that is not taken by unaffiliated programmers), the Commission asks whether there are circumstances in which the one-third limitation can be exceeded. For example, the Commission asks, if only one unaffiliated packager seeks capacity, is it appropriate for that packager to be able to obtain all of the remaining exclusive channels?

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<sup>8</sup> Id. at 20.

We maintain that “one-third means one-third.” If circumstances develop such that only one unaffiliated packager seeks capacity, that does not alter the statutory scheme. If Congress had wanted the Commission to depart from the one-third limitation where only one unaffiliated packager sought capacity, it could have said so. Since it did not, the one-third limitation stands.

LECs nonetheless maintain that the Commission must intervene to obviate the possibility that a competitor will obtain more channels than the OVS operator’s programming entity. The Joint Telephone Parties, for example, call for a rule under which “no individual unaffiliated video programming provider...[would]...be allowed to select the programming on more channels than the open video system operator and its affiliates.”<sup>9</sup> U S WEST contends that it will be deterred from constructing OVS systems if it faces a competitor with more than one-third of the channels.<sup>10</sup>

This proposed deviation from the statute should not be adopted. The Commission should stick to the plain meaning of the statute and not authorize OVS operators to occupy more than one-third of the available channels on scarce capacity systems.

Finally, it is worth noting while the LECs object to the availability to a single competitor of more than one-third of the capacity, they also advocate a must carry and channel sharing arrangement that would provide less than one-third of the available exclusive channels to *all* competitors. As noted in the above examples, if neither must carry nor shared channels are counted against an OVS operator’s exclusive allocation, less than one-third of the remaining channels are available to all competitors.

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<sup>9</sup> *Id.* at 18.

<sup>10</sup> U S WEST Comments at 13-14.

**E. Capacity Allocation Procedure**

Our comments called upon the Commission to adopt a formal open enrollment procedure to allocate capacity where demand exceeds supply. A formal and uniform procedure is far better than an arrangement under which individual programmers throughout the country must learn of the different arrangements offered by each OVS operator. NCTA proposed a requirement that an OVS operator advertise the availability of capacity at publicly filed rates, and that the OVS operator conduct an open enrollment period that lasts for a minimum of four weeks. All requests submitted during the open enrollment period would be considered made “at the same time” for “first-come, first-served” purposes. At the conclusion of this period, the OVS operator would announce the results, and the programmers would then determine the extent to which shared channels can satisfy capacity requirements. The OVS operator would then allocate the available exclusive channels to the unaffiliated programmers in proportion to the number of requested channels.

Telephone companies, in the name of leaving matters to “the marketplace,” oppose a procedure that will stabilize the marketplace for channels available to unaffiliated programmers. NYNEX argues that “When capacity constraints arise, the operator should be able to employ any nondiscriminatory procedure to allocate capacity.”<sup>11</sup> USTA opposes a channel allocation procedure, and argues for OVS operator discretion, because of “uncertainty surrounding the potential network architectures and service arrangements for open video systems.”<sup>12</sup> U S

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<sup>11</sup> Comments of NYNEX, Apr. 1, 1996, at 7 (“NYNEX Comments”).

<sup>12</sup> Comments of the United States Telephone Association, Apr. 11, 1996, at 17 (“USTA Comments”). As to different architectures, we have no idea what USTA is talking about. We assume that it is planning, like everyone else, to deploy a hybrid fiber/coax architecture.

WEST, arguing that “one size does not fit all,”<sup>13</sup> argues that the OVS operator should be permitted to allocate capacity without any further Commission guidance.

The rationales of the telephone parties should not be given credence. They are obviously seeking maximum discretion so that they are able to control the channel allocation process and to preserve an ability to discriminate against competitors to the maximum extent. The establishment of a clearly understood channel allocation process, and a mechanism for ensuring that it is enforced, is essential to unaffiliated programmers that expect nondiscriminatory access to the OVS facility.

**F. Analog/Digital Issues**

NCTA’s comments noted that the OVS operator’s offering of analog and digital services are different. If the OVS operator offers analog channels, it cannot satisfy its obligation to offer programmers nondiscriminatory access to channel capacity by offering digital channels. Drawing this distinction is particularly important because, at the present time, the consumer base of television receiving devices is analog, and consumers will have to bear an additional expense to convert their sets to digital capability. In addition, the digital transmission and other costs may exceed those of analog.

If, for example, the OVS-affiliated package consumes all of the analog channels, while unaffiliated competitors are forced onto digital capacity, the OVS operator will gain a significant competitive advantage. Many end-users may be disinclined to purchase the digital capability, if they can obtain a satisfactory package of programming delivered over the analog channels. Such discrimination is intolerable, as well as unlawful.

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<sup>13</sup> U S WEST Comments at 16.

The Joint Telephone Parties nonetheless propose a scheme that will have just this consequence.<sup>14</sup> They argue that competitive necessity and “business flexibility” justify permitting OVS operators “to select programming for any one-third of the activated channels to the extent necessary to compete effectively with incumbent cable operators.”<sup>15</sup> The Joint Telephone Parties conclude that “Congress did not distinguish between analog and digital channels for this purpose. Neither should the Commission.”<sup>16</sup>

Acceptance of the Joint Telephone Parties’ proposal would be the single most serious blow to unaffiliated programmers hoping to compete with the OVS operator’s programming package. If the analog/digital service offerings are not distinguished, the OVS operator might satisfy the one-third capacity limitation by providing 100 analog channels to itself, and by offering 200 digital channels to competitors. For all practical purposes, this would circumvent the one-third limitation. The Commission should, instead, impose upon OVS operators separate obligations to offer nondiscriminatory access to programmers on analog and digital channels.

**G. Changes in Demand/Capacity**

The OVS operator’s programming entity is permitted to exceed the one-third capacity limit if excess capacity is available following conclusion of the initial period for requesting channels. Subsequently, unaffiliated programmers may request capacity. The Commission asked whether in that circumstance the affiliated programmer should be required to relinquish capacity immediately, following a transition period, or not at all.

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<sup>14</sup> Joint Telephone Parties at 14-15.

<sup>15</sup> Id.

<sup>16</sup> Id. at 15.

NCTA supported a reasonable transition period subject to three qualifications. First, part-time users should be accommodated. Second, if new capacity becomes available, that capacity should be subject to a new open enrollment period. And third, unaffiliated programmers that have properly arranged for carriage with the relevant program network should be allowed to share any channel on the system.

U S WEST, in contrast, “believes that a three-year period is the absolute minimum necessary to attract VPPs to OVS with a five-year period being more economically reasonable.”<sup>17</sup> The Joint Telephone Parties oppose a fixed time limit, but suggest that “if carriage is offered on fixed duration contracts (e.g., 5 years), then a reasonable period of time would be until the next anniversary of those contracts.”<sup>18</sup> NYNEX also supports the notion that OVS operators not be required to engage in new periodic enrollments more frequently than every five years.<sup>19</sup>

NCTA continues to believe that a shorter period is sufficient to enable OVS operators to transition to new arrangements. One year strikes the appropriate balance between the accommodation of unaffiliated programmers and the time necessary for the OVS operator’s programming entity to adjust.

#### **H. The “Head Start” Issue**

NCTA’s comments called for preventing the OVS operator’s video programming entity from commencing service to end-users before competitors. If the operator’s package is “first in

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<sup>17</sup> U S WEST Comments at 12.

<sup>18</sup> Joint Telephone Parties at 16.

<sup>19</sup> NYNEX Comments at 9.

the market,” it will gain an obvious competitive advantage. The telephone parties did not seek the ability to begin service before others, and should not object to this rule of basic fairness. The requirement of nondiscriminatory access should be interpreted to require that all programmers have the ability to begin service at the same time as the OVS operator’s programming service.

### **I. Dispute Resolution**

NCTA’s comments advocated a dispute resolution process that contained “concrete procedures to make clear to OVS operators that discrimination and other forms of anticompetitive and anticonsumer practices will not be tolerated.”<sup>20</sup> Our comments called for a process to resolve disputes expeditiously, noting that the statutory 180-day period for resolving complaints should not be interpreted as authorizing a LEC to engage in discrimination and other improper conduct for a full 180 days. We also opposed an entirely open-ended process in which operators are permitted to defend the reasonableness of “blatantly discriminatory conduct.”<sup>21</sup> It is probably advisable that the Commission set forth in advance an illustrative list of prohibited practices to minimize areas of dispute.

There is no dispute that a process is necessary; only the particulars of the process are in question. The Joint Telephone Parties submit an 11-page proposal that will certainly provide the Commission with all of the information it could possibly want regarding a particular situation.<sup>22</sup> It may be, however, that a somewhat shorter process will provide the necessary information, and

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<sup>20</sup> Comments and Petition for Reconsideration of the National Cable Television Association, Inc., Apr. 1, 1996 at 17.

<sup>21</sup> Id.

<sup>22</sup> See Joint Telephone Parties Appendix at 7-17.

impose less of a burden upon all concerned. The Commission should carefully evaluate the information that it needs to expeditiously and fairly resolve complaints.

## **II. THE STATUTE REQUIRES JUST AND REASONABLE RATES**

NCTA noted in its comments that the Act calls for regulations to “ensure that the rates, terms, and conditions” for the carriage of programming on an open video system “are just and reasonable and are not unjustly or unreasonably discriminatory.”<sup>23</sup> The NPRM seems to suggest, however, that the statutory language does not result in a requirement that the Commission affirmatively find that the rates are “just and reasonable.” It argues that because the review period is limited, and Congress barred Title II-like rate regulation, regulatory supervision should be either significantly truncated or left to the marketplace.

NCTA’s comments pointed out that, in contrast to cable operators that offer service to end-users, OVS operators will offer capacity to video programmers with whom they will compete. Two potential problems may arise if channel capacity rates are not regulated. First, OVS operators may charge rates that are so excessive that unaffiliated programmers will be dissuaded from using the facility. Should that occur, the OVS operator’s anticompetitive pricing strategy will be rewarded by enabling the operator’s programming entity to control more channels. And second, “by focusing on the OVS operator-end user relationship, the Commission ignores the possibility that the OVS operator will engage in a price squeeze, charging unjustifiably high rates to programmers for access, while keeping the end-user rate at competitive levels.”<sup>24</sup>

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<sup>23</sup> 1996 Act, § 653 (b)(1)(B).

<sup>24</sup> NCTA Comments at 18.

The statute, by its terms, requires the Commission to find that OVS rates to programmers are just and reasonable, and not unjustly or unreasonably discriminatory, when measured against some standard. NCTA does not currently support any particular standard, but believes that two steps are essential. First, the Commission must remain directly involved in rate regulation to ensure that the OVS operator does not charge different rates to different programmers for the same service; *i.e.*, to make certain that the service is offered at nondiscriminatory rates. And second, rates must be publicly filed so that programmers are assured that they are all obtaining the same service at the same rates.

The telephone company parties see the situation differently. They maintain that “the marketplace” will guarantee the reasonableness of rates. NYNEX contends that “the economic self-interest of the OVS operator will require it to price access at reasonable rates so as to attract ... programmers.”<sup>25</sup> But it does not explain why the OVS operator’s economic self-interest will not inspire it to charge rates so high that no unaffiliated packager takes capacity, enabling the OVS operator’ programming entity to control all the channels without obtaining a local franchise.

U S WEST also contends that the market will constrain OVS rates.<sup>26</sup> The company analogizes its participation as an OVS operator to that of a non-dominant telecommunications carrier identified in the Competitive Carrier proceedings.<sup>27</sup> U S WEST argues that like non-dominant carriers, OVS operators will be “new entrants” lacking market power and unable to

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<sup>25</sup> Comments of NYNEX, Apr. 1, 1996, at 22-23.

<sup>26</sup> Comments of U S WEST at 4-7.

<sup>27</sup> *Id.*

raise prices or “to engage in unreasonable price discrimination under the Commission’s traditional analysis.”<sup>28</sup> But as explained above, U S WEST’s attempted analogy to Competitive Carrier does not work because without regulation OVS operators *can* discriminate against other unaffiliated video packagers/programmers seeking channels on their facility. Unless rates are publicly filed, and programmers are assured of the same rates as the OVS operator’s programming entity, the operator can attempt to dissuade unaffiliated programmers from seeking system capacity by charging discriminatory rates. If the OVS operator’s strategy is successful, it ends up controlling more channels.

The Joint Telephone Parties take a somewhat different approach. They seemingly contend that since Title II-like rate regulation of OVS is not permitted, no rate regulation is permitted.<sup>29</sup> But as NCTA noted in its Comments, the Commission regulates cable rates, and that rate regulation scheme is not a common carrier scheme.<sup>30</sup> The Commission can engage in regulation of OVS rates to programmers without running afoul of the statute.

The Joint Telephone Parties also argue that they “strongly oppose any requirement that they be required to make their contracts public.”<sup>31</sup> They contend that public filing is burdensome and would contradict Commission actions in common carrier proceedings in which the agency found that “public rate filings in competitive markets lead to price coordination and are not in the public interest.”<sup>32</sup> But the Joint Telephone Parties’ attempt at analogy is

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<sup>28</sup> Id.

<sup>29</sup> Joint Telephone Parties at 22.

<sup>30</sup> NCTA Comments at 18.

<sup>31</sup> Joint Telephone Parties at 22.

<sup>32</sup> Id. (citation omitted).

misplaced. OVS is not the same as interexchange telephone service provided by nondominant carriers because unaffiliated *packagers*, unlike long distance customers, may not have ready alternative suppliers of transmission capacity. Moreover, the public filing of rates is essential to ensure that OVS operators do not engage in unjust or unreasonable rate discrimination.<sup>33</sup>

Finally, NCTA's comments emphasized that the Commission should find that "regulatory parity is necessary."<sup>34</sup> If the Commission concludes that OVS rates will not be regulated on the grounds that the marketplace is competitive, it should reach the same conclusion with respect to rates for commercial leased access offered by cable systems pursuant to Section 612 of the Cable Act. If consumers, *in that instance packagers/programmers seeking OVS capacity*, are involved in a sufficiently competitive market to warrant rate deregulation, the same or similar circumstances apply to programmers seeking commercial leased access capacity, and the same result should be reached.

### **III. SAFEGUARDS TO POLICE CROSS-SUBSIDY AND DISCRIMINATION REMAIN NECESSARY**

NCTA's comments called for three special safeguards that are necessary because a telephone company providing video programming over an integrated network has special incentives and abilities to cross-subsidize the competitive video operation and to discriminate against competitors. We urged the Commission to articulate effective cost allocation rules so that telephone ratepayers are not burdened by a telcos' uncertain video ventures, competitors do

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<sup>33</sup> We reiterate, however, the Commission should confirm that the public filing of OVS rates would not, under any circumstances, result in "the public availability of program license agreements between either programming networks or video programming providers. These program license agreements would remain subject to all of the confidentiality provisions contained within them." NCTA Comments at 20, n.16.

<sup>34</sup> NCTA Comments at 20.

not face discrimination, and competition at subsidized rates. We sought a joint marketing procedure that prevents telephone company marketing personnel from using a customer request for telephone service as an opportunity to sell telco OVS service, unless the customer is also made aware of cable service alternatives. And, we advocated the offering of a telephone company's OVS service through a separate corporate subsidiary to facilitate the detection of discrimination and cross-subsidy. Following review of the comments, we continue to believe each of these measures absolutely essential.

**A. Cost Allocation**

NCTA's comments called for cost allocation rules that assign all of the direct cost and an appropriate share of common cost to OVS. We endorsed the Commission's decision to work out the specifics in a separate proceeding to be conducted by the Common Carrier Bureau. This proceeding should be completed promptly. But until it is completed, LECs should not offer OVS.

LECs respond either by ignoring cost allocation, or, with one limited exception, by contending that no further action is necessary. The Joint Telephone Parties, for example, assert: "There is no need for the Commission to take any action regarding cost allocation prior to certification or to impose cost allocation requirements as a condition for certification. The Commission already has rules in place in Part 64 that fully accommodate the joint provision of common carrier and non-common carrier services."<sup>35</sup> NYNEX and USTA barely touch upon the matter. U S WEST maintains, "Cost allocation should play no role in the pricing of OVS."<sup>36</sup>

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<sup>35</sup> Joint Telephone Parties at 31.

<sup>36</sup> U S WEST Comments at 8.

U S WEST nevertheless concedes that common costs must be properly allocated, and we agree with U S WEST that common cost issues should be addressed in a separate Common Carrier Bureau proceeding. U S WEST correctly observes that “The issue is how costs associated with the underlying common transport infrastructure should be assigned to video and telephony.”<sup>37</sup> Once that assignment is determined, the decision will inevitably play a role in the pricing of OVS. U S WEST is also incorrect when it maintains that “the need for allocating common costs between telephony and video [arises only] in those states where telephone operations are still subject to rate of return regulation.”<sup>38</sup>

That is surely not right. As explained previously on numerous occasions, unless regulators adopt and telephone companies abide by a “pure” price cap -- a cap on rates that is not ever subject to adjustment -- the Averch-Johnson incentives of the rate-of-return regulated firm to over invest so as to increase profits on an artificially inflated rate base will not be completely removed.<sup>39</sup> Neither the Commission nor any state regulatory agency has yet adopted a pure price for a LEC. Moreover, nothing has happened to change the political imperative that will force regulators to authorize rate increases if the local telephone company experiences financial difficulty, and to require rate decreases if the company earns massively excessive profits.<sup>40</sup>

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<sup>37</sup> Id. at 9 (citation omitted). U S WEST is also correct that “This same question arises whether a LEC becomes an OVS operator or acts as both a telephone common carrier and a cable operator using an integrated network, as the law allows.” Id.

<sup>38</sup> Id. at 8-9.

<sup>39</sup> See e.g., Declaration of Leland L. Johnson, appended to NCTA Comments, at 7-13.

<sup>40</sup> See id. at 7, quoting Alfred E. Kahn, Review of Regulatory Framework, Canadian Radio-Television and Telecommunications Commission, Telecom Public Notice CRTC 92-12. Filed on behalf of AGT, Apr. 13, 1993, at 21. (“To be sure, we have to my knowledge yet to see a scheme of pure price cap

Common costs are a major portion of the total costs of integrated networks.<sup>41</sup> There is no economically correct way to allocate these costs between telephone and video services; any result that regulators reach is inevitably derivative of policy goals. It is the Commission's role to determine its goals, and to decide the appropriate allocation of common costs.

Since improper cost allocations continue to pose genuine risks to consumers and competition, OVS certifications should be made contingent upon the completion of the separate Common Carrier Bureau proceeding to establish cost allocation rules for OVS. Until cost allocation rules that take account of OVS are in place, consumers cannot have confidence that cross-subsidy will be averted.<sup>42</sup> NCTA also agrees with the comments of NARUC which call for the establishment of a Federal-State Joint Board to address separations questions.<sup>43</sup>

#### **B. Joint Marketing**

NCTA's comments also called for an in-bound telemarketing restriction, to stay in place until local telephone service is fully competitive, on the incumbent LEC's exclusive referral of

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regulation. All of the schemes of which I am aware contemplate review within a few years of how they are working....Such reexaminations have typically involved some correction of the formula if profits prove too high or too low -- in which event price regulation turns out to resemble rate of return regulation.")

<sup>41</sup> See e.g., Declaration of Leland L. Johnson, appended to NCTA Opposition to Direct Case, Nov. 30, 1995, at 37-38.

<sup>42</sup> The importance of an effective cost allocation process is persuasively demonstrated by the Comments of six public interest groups. See Comments of the Alliance for Community Media, Alliance for Communications Democracy, Consumer Federation of America, Consumer Project on Democracy, Center for Media Education, and People for the American Way, Apr. 1, 1996, at 4-7 ("Public Interest Comments").

<sup>43</sup> See, Initial Comments of the National Association of Regulatory Utility Commissioners, Apr. 1, 1996, at 7-9.