

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

In the Matter of)
Annual Assessment of the Status of) CS Docket No. 96-133
Competition in the Market for the)
Delivery of Video Programming)

To: The Commission

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COMMENTS OF OPTEL, INC.

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SUMMARY

In the NOL, the Commission requests information regarding the initial effects of the 1996 Telecommunications Act (the "1996 Act") and any other matter pertaining to the state of competition in the multichannel video programming market. As one of the leading private cable companies in the United States, OpTel competes directly with franchised cable operators in a number of local video distribution markets. Although OpTel welcomes some of the changes made by the 1996 Act (*e.g.*, the expansion of the private cable exemption) because they will allow OpTel to compete with franchised cable operators in a wider variety of arenas, other statutory changes will make it more difficult for the Commission to address anticompetitive practices that are commonplace in today's MVPD market. For instance, changes made to the uniform rate requirement could make it easier for franchised cable operators to target discounts to property owners and residents selectively in order to foreclose entry by a competitor, unless the Commission adopts a "bright line" test of predatory pricing to implement the statutory provision.

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COMMENTS OF OPTEL, INC.

OpTel, Inc. ("OpTel"), submits these comments in response to the Notice of Inquiry ("NOI") in the above-referenced proceeding. OpTel, through its subsidiaries, operates private and franchised cable systems in several regions of the United States. In the NOI, the Commission requests information regarding the initial effects of the 1996 Telecommunications Act (the "1996 Act") and any other matter pertaining to the state of competition in the multichannel video programming market.¹

As one of the leading private cable companies in the United States, OpTel competes directly with franchised cable operators in a number of local video distribution markets. Although OpTel welcomes some of the changes made by the 1996 Act (*e.g.*, the expansion of the private cable exemption) because they will allow OpTel to compete with franchised cable operators in a wider variety of arenas, other statutory changes will make it more difficult for the Commission to address anticompetitive practices that are commonplace in today's MVPD market.

For instance, changes made to the uniform rate requirement could make it easier for franchised cable operators to target discounts to property owners and residents selectively in order to foreclose entry by a competitor, unless the Commission adopts a "bright line" test of predatory pricing to implement the statutory provision. OpTel's comments below address this, and other issues, more fully.

¹ NOI 96-11.

I. OPTTEL IS ONE OF THE LEADING PRIVATE CABLE OPERATORS IN THE COUNTRY.

OpTel provides video programming services to 110,000 customers under cable service agreements it has entered into with owners and residents' associations of 220,000 housing units in multiple dwelling units ("MDU") in the United States.

OpTel operates in San Diego and Los Angeles, California; Phoenix, Arizona; Denver and Colorado Springs, Colorado; Houston, Dallas-Ft. Worth and Austin, Texas; Chicago, Illinois; and Miami-Ft. Lauderdale, Florida. It will shortly enter the San Francisco, California and Tampa, Florida markets.

The Company currently targets MDUs having over 150 units per property. By this measure, OpTel believes that its market share ranges from 4% to 25% in the markets in which it is now operating.

OpTel provides — or furnishes through branding arrangements — other networked and communications services in selected markets. Certain services are directed toward property residents, while others are directed toward property owners. These services include local and long distance telephone service, alarm line monitoring and closed-circuit security camera service. Its business plan includes an ambitious roll-out of local telephone service, Internet access and other services.

II. LECs ARE NOT YET A COMPETITIVE FORCE IN THE MARKET.

As the Commission, the Department of Justice, and the courts have found, the present market for multichannel video programming services remains highly concentrated and the pro-competitive impact of the 1996 Act is yet to be felt. The one segment of the market that has witnessed a significant increase in the level of competition in recent years, however, is the market for video services to MDUs. Not coincidentally, this is the only segment of the market that, until the passage of the 1996 Act, private cable operators were permitted to serve.

In the 1996 Act, Congress sought to break the franchise cable monopoly. One means of doing so, it determined, was to unleash the local telephone companies, which are monopolists in the local exchange market, into the MVPD market. To that end Congress eliminated the cable-telco cross-ownership ban and opened the way for local exchange carriers to provide multichannel video programming service directly to

subscribers in any of four ways: As a franchised cable operator under Title VI; through radio communication under Title III (e.g., MMDS); as a common carrier video platform under Title II; or by means of an open video system under new Section 653.

In conjunction with this pro-competitive approach, Congress included provisions in the 1996 Act that would exempt franchised cable operators from most rate regulation once they face "effective competition" from a LEC-affiliated video programming provider. The Congressional vision, thus, was of two well-capitalized monopolists grappling for subscribers in each community, each having a strong preexisting client base. It was hoped that these two behemoths would check one another's ability to price in anticompetitive ways and that other providers would emerge in the process to create a fully competitive market.

As the Commission knows, that vision remains but a vision. LEC forays into the MVPD market thus far have been sporadic, widely dispersed, and quickly aborted. Although there is every expectation that the LECs will one day be a competitive force in the MVPD market, that day has not arrived. Meanwhile, regulation of franchised operators' rates remains essential for the protection of new entrants seeking to gain access to the market. Further, the vision is least likely to be realized in the MDU marketplace. To date, LEC entry announcements have been in the MMDS arena, a technology that does not land itself to MDUs.

In this regard, OpTel has urged the Commission to require that a cable operator claiming to face "effective competition" from a LEC-affiliated provider affirmatively demonstrate that the availability of the LEC provider's programming actually is having a restraining effect on cable rates.² One administratively-efficient means of doing so would be to establish a test, resembling the absolute subscriber pass and subscription rates applicable under the other "effective competition" provisions of the 1996 Act, for determining the point at which a LEC-affiliated programming distributor is providing effective competition to a franchised operator.

For instance, the Commission could use some relative measure of service availability and subscriber access. Such a test for effective competition would not turn upon some non-statutory absolute pass rate for the LEC-affiliated provider, but it would ensure that the LEC-affiliated entity could provide a real check on the competitive practices of the franchised operator seeking to escape rate regulation.

² See Implementation of the Cable Reform Provisions of the Telecommunications Act of 1996, CS Docket No. 96-85, Comments and Reply Comments of OpTel.

If the Commission frees franchised cable operators from rate regulation prior to the time that they face actual effective competition, the franchised operators will target price discounts in areas in which new competitors are seeking to compete. Indeed, the mere threat that they may do so is sufficient to discourage many would-be competitors from entering the market. A clear, effective "effective competition" test thus is essential to the fulfillment of the Congress' competitive vision.

III. THE UNIFORM RATE REQUIREMENT MUST BE IMPLEMENTED IN A MANNER THAT WILL PROVIDE MEANINGFUL PROTECTION AGAINST ANTICOMPETITIVE PRACTICES.

The changes made in the 1996 Act to the uniform rate requirement of Section 623(d) of the Communications Act also are of great concern to OpTel. One of the most important aspects of cable rate regulation, at least for purposes of preserving a level competitive field, is the uniform rate requirement. As the Commission itself has recognized, the uniform rate requirement prevents cable operators from "undercutting potential competitors by offering lower rates only in areas where competitors seek to offer a competing service."³

In the 1996 Act, Congress modified, but did not eliminate, the uniform rate requirement. Most importantly, new Section 623(d) provides that bulk discounts to MDUs are exempt from the requirement, except that bulk discounts that are "predatory" are prohibited. The Act states that, "[u]pon a *prima facie* showing by a complainant that there are reasonable grounds to believe that the discounted price is predatory, the cable system shall have the burden of showing that its discount price is not predatory."⁴ In its implementation of this new provision, the Commission is presented with a clear choice between rules that will promote competition and rules that will allow the dominant MVPD service provider to eliminate nascent competition.

For instance, because the scope of the Commission's definition of "bulk discounts" will determine the extent to which cable operators may escape this important competitive check and target discounts discriminatorily to consumers who have competitive choices, it is critical that the Commission's rules confine the exemption to include only those situations in which a discount is deducted from a bulk payment paid by a property owner or other responsible agent on behalf of the residents of an MDU.⁵

³ SBC Media Ventures, Inc., 9 FCC Rcd 7175, 7177 (1994).

⁴ Communications Act, § 623(d).

⁵ See Implementation of the Cable Reform Provisions of the Telecommunications Act of 1996, CS Docket No. 96-85, Notice of Proposed Rulemaking, ¶ 98 (the exemption from the uniform rate

Similarly, if the uniform rate provisions are to mean anything in the MDU context, the Commission's implementing rules must interpret the predatory pricing restriction broadly enough to encompass all pricing that is targeted at driving a competitor from the market. For this reason, OpTel has suggested that, for purposes of enforcing Section 623(d), a discount of more than 25% should be conclusively presumed to be predatory.⁶ Discounts of greater than 25%, it can be assumed, are offered only to eliminate incipient competition in a particular MDU or geographic region. Further, although franchised operators now may charge non-uniform bulk discounts to MDUs, such non-uniform bulk discounts nonetheless should constitute *prima facie* evidence of predatory pricing. The burden then would be on the cable operator offering a non-uniform bulk discount to demonstrate that the discount is not predatory.

Further, cable operators have been very creative in the way they have skirted the edges of non-compliance with the uniform rate regulations that prevailed in the past. They have even gone as far as to require the property owner to sign separate "cable service" and "wiring" or "easement" agreements. It is not coincidental that the revenue sharing and discount provisions are not in the "cable service" agreement, but in the others. Accordingly, OpTel proposes that the benefit of all appurtenant agreements be considered when calculating the magnitude of the discounts, regardless of who receives them or in which agreements they are incorporated.

IV. THE USE OF PERPETUAL CONTRACTS BY FRANCHISED CABLE OPERATORS FORECLOSES MDUS TO NEW ENTRANTS AND INHIBITS THE GROWTH OF COMPETITION.

In the NOI, the Commission has asked the industry to comment on various issues surrounding property owners' having, in the past, granted exclusive rights to provide video programming services to MDUs to cable companies where such rights have become virtually perpetual. It has raised the possibility of mandating access to MDU residents to all who wish it. Implicit in this proposal is a model of competition in which large, well-capitalized telecommunications companies might overbuild one another within the same MDU property. That model is most consistent with a duopoly consisting of the incumbent cable and telephone monopolies.

requirement for bulk discounts was not intended to apply where cable operators "offer discounted rates on an individual basis to subscribers simply because they are residents of an MDU").

⁶ Based on OpTel's calculations, a 25% discount would reduce normal operating margins by approximately 50%.

As described in Part II, OpTel has a different analysis of the likely evolution of MVD competition in the MDU marketplace. For the reasons set forth in more detail below, OpTel's analysis leads it to conclude that it is the perpetual nature of contracts, not their exclusivity, that hampers the development of competition with cable operators. First, the capital costs involved will make significant overbuilding unlikely within MDU properties. Second, while the LEC's are now discussing providing one-stop access to cable and telephone services, the private cable industry is *already* providing one-stop access to these and other services. Private cable operators are able to provide these services because of the exclusive, but time-limited, exclusivity that the owner grants.

The Commission has raised the possibility of establishing a federal right of "mandatory access," which would require property owners to open their property to all service providers.⁷ OpTel strongly opposes such a requirement. Commission-imposed mandatory access would inhibit, rather than promote, the development of competition in the MVPD market.⁸ Private cable companies install and maintain an entire distribution network at each property. Although a franchised cable operator can amortize the cost of serving an MDU over its entire franchise area, private cable companies must recoup their investment through each MDU served. Thus, exclusivity, for a reasonable period of years, is essential to the ability of alternative video programming distributors to compete. It comes as no surprise to OpTel that the private cable industry has tended to flourish in southern states, which do not have in force various "cable access" laws, and not in the North, where such laws are more commonplace.

The availability of exclusive rights-of-entry also allows MDU property owners and ownership associations to bargain with service providers for superior video and telecommunications services for MDU tenants and residents. These services enhance the property's attractiveness to potential tenants and enhance property values. The rental housing industry is intensely competitive. A mandatory access requirement would deprive property owners of an essential tool in the competition for MDU residents and would deprive condominium owners' associations of the control of what takes place in their home.

It is not exclusive contracts that are the problem in the MVPD market, but perpetual, exclusive contracts. Perpetual, exclusive contracts foreclose a large segment of

⁷ Telecommunications Services Inside Wiring, CS Docket No. 95-184.

⁸ Mandatory access requirements also would constitute a *per se* "taking" of private property. Lacking clear statutory authority, the Commission may not effect such a taking. See Bell Atlantic Tel. Co. v. FCC, 24 F.3d 1441, 1445 (D.C. Cir. 1994).

the MDU market, and access to countless consumers, to competitors of the franchised cable operators. Typically, the exclusive contracts used by franchised cable operators run for the term of their franchise and any renewals or extensions thereof. Because franchise renewals and extensions are all but automatic, the terms of these contracts are, for all practical purposes, perpetual

Most perpetual contracts were executed in the 1970s and 1980s before competitive alternatives to franchised cable were available. At that time, franchised cable operators were able to approach MDUs with a deal that only a monopolist can offer: Take our service on our terms, exclusively, in perpetuity, or leave your residents entirely without television service. Given their unequal bargaining power, MDU owners, residents and managing agents were compelled to accept service on these terms and could not have imagined ever having a choice.

Now, when there are an increasing number of competitive alternatives to the franchised cable operators to serve the telecommunications needs of MDU residents, the established base of perpetual, exclusive contracts represents a substantial barrier to competitive entry. It is this barrier to entry, made up of old contracts, that the Commission should deal with on a one-time basis and not affect the present and future contracting ability and private property rights of MDU owners and service providers in an increasingly competitive marketplace.

Although a mandatory access requirement would eliminate perpetual contracts, it also would sweep in a wide variety of pro-competitive, non-perpetual exclusive contracts. Consequently, OpTel suggests that, rather than impose a mandatory access regime, the Commission should apply a "fresh look" policy to those perpetual contracts that now are in effect and then allow parties to contract as they see fit in response to consumer demands and needs in the marketplace.

A. Fresh Look.

The Commission previously has imposed "fresh look" obligations on dominant telecommunications providers to prevent them from using their market power in anticompetitive ways.⁹ "Fresh look" allows customers committed to long-term contracts with a dominant provider to take a fresh look at the marketplace once competition is

⁹ See Competition in the Interstate Interexchange Marketplace, 7 FCC Rcd 2677, 2678 (1992); Expanded Interconnection with Local Tel. Co. Facilities, 8 FCC Rcd 7341, 7342-43 (1993), vacated on other grounds, Bell Atlantic Tel. Co. v. FCC, 24 F.3d 1441 (1994).

introduced and to escape or renegotiate those contracts if they so desire. This approach “makes it easier for an incumbent provider’s established customers to consider taking service from a new entrant.... [and] obtain ... the benefits of the new, more competitive ... environment.”¹⁰

In this case, the Commission, the Department of Justice, and the courts have found that franchised cable operators are the dominant providers in the MVPD market.¹¹ The existence of perpetual contracts allows franchised cable operators to maintain their dominant position, particularly because most private cable operators, daunted by the capital costs, do not even attempt to compete for MDUs that are bound up in perpetual contracts. There will not be significant competition in the MDU market until the barrier to entry represented by perpetual contracts is eliminated.

As in previous instances in which the “fresh look” doctrine has been applied, the customers of dominant service providers should be given a fixed period of time within which to opt-out of their contracts.¹² The characteristics of the MVPD marketplace require that the “fresh look” window in this case should be at least 180 days. In the MVPD market, it may take a new entrant several months to obtain necessary approvals and construct the facilities needed to serve any given MDU.

OpTel believes that it would be most appropriate that the effect of a decision of an MDU owner to terminate a long-standing cable company perpetual contract be that the termination take effect after 90 days, or less at the owner’s option. This will allow the incoming competitor enough time to build out its system and effect a smooth cutover of service.

Finally, the fact that franchised cable operators hold a series of dispersed monopolies rather than a single national monopoly requires that the “fresh look” window be tailored to the local MVPD markets. MDU owners and ownership

¹⁰ Expanded Interconnection with Local Tel. Co. Facilities, 9 FCC Rcd 5154, 5207 (1994).

¹¹ See In re Revision of Rules and Policies for the Direct Broadcast Satellite Service, IB Docket No. 95-168, PP Docket No. 93-253, Comments of the United States Department of Justice at 2 (filed Nov. 20, 1995); In re Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, CS Docket No. 95-61, ¶ 215 (rel. Dec. 11, 1995); Turner Broadcasting v. FCC, 910 F. Supp. 734, 740 (D.D.C. 1995).

¹² In Competition in the Interstate Interexchange Marketplace, the Commission determined that a ninety-day “fresh look” period was sufficient for long-distance customers to evaluate their options and negotiate new contracts when 800 numbers became portable. See 6 FCC Rcd at 5906. When the Commission later confronted expanded interconnection to local exchange facilities, it provided for a 180-day “fresh look” window, recognizing that it would take longer than ninety days for the market to respond to expanded interconnection opportunities. See 8 FCC Rcd at 7353 & n.48..

associations must be freed from their perpetual contracts in order to create competition in each locality.

Thus, prior to the time when a franchised cable operator is subject to "effective competition" under Section 623 of the Communications Act, the fresh look window should be "opened" at any given MDU upon the request of a private cable company able to serve the MDU in question. Moreover, once a franchised cable operator has been found subject to "effective competition," even in the absence of a prior request, the six month fresh look window should begin. During the fresh look period, the property owner or ownership association could renegotiate or terminate its contract with the franchised cable operator free from contractual penalties or breach of contract litigation.

Application of the "fresh look" doctrine will allow the Commission to cease to regulate in this area entirely once there is actual or "effective" competition. At that point, MDU owners and ownership associations that enter into disadvantageous service contracts for their buildings do so, presumably, with full knowledge that competitive alternatives exist. The residential real estate industry and associations of condominium owners will self-regulate against such errors.

As a result of the cable companies' propensity to sign multiple types of agreements to document its business arrangements with MDU owners, OpTel proposes that the "Fresh Look" apply to all relevant documents and agreements.

B. Legal Authority

The Commission has ample authority to apply its "fresh look" doctrine to the perpetual contracts of franchised cable operators. Under Title VI, the Commission is required to ensure that the rates charged to subscribers by cable systems not subject to effective competition are reasonable.¹³ Although previous "fresh look" cases involved the regulation of common carriers under Title II of the Communications Act, the Commission's responsibility to regulate cable rates under Title VI is comparable.¹⁴

In its "fresh look" proceedings under Title II, the Commission has held that the use of long-term contracts to leverage market power from a non-competitive market into a competitive one, or from a market that is not yet competitive into the future, is

¹³ 47 U.S.C. § 543(b).

¹⁴ Cf. Implementation of Section of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation, 8 FCC Rcd 5631, 5723 (1993) (analogizing rate prescription under Title VI to rate prescription under Title II).

an unjust and unreasonable practice.¹⁵ It is no less unreasonable in the Title VI context. Application of the “fresh look” doctrine is necessary to eliminate the market barrier erected by franchised cable operators between their captive customers and competing MVPD service providers.

In addition, application of the “fresh look” policy to the perpetual service contracts of franchised cable operators would help the Commission to fulfill its obligations under Section 257 of the Communications Act, supplemented by the Telecommunications Act of 1996, which requires that the Commission identify and eliminate market entry barriers for entrepreneurs and small businesses.¹⁶ Only by opening up the perpetual service contracts of the franchised cable operators will new entrants into the MVPD market have an opportunity to compete.

V. Program Access Restrictions Still Are Being Used To Impede Competition.

In the NOL, the Commission has asked for information on the “effectiveness of [its] program access rules.”¹⁷ Although the Commission’s program access rules encompass a wide variety of anticompetitive conduct, there are still programming providers seeking to skirt those rules. In one instance, OpTel has filed a programming access complaint challenging such an attempt.¹⁸ In this instance, a cable company denied programming to OpTel citing its “grandfathered” (*i.e.*, pre - 1992) status, but allowed another operator access in exactly the same market. Such action can have only one interpretation: selective anti-competitive aegis. In order for the Commission’s programming access to rules to be “effective,” they must have teeth. For that reason, OpTel urges the Commission to expedite review of complaints filed charging violations of the programming access rules.

CONCLUSION

Franchised cable operators have inhibited the development of competition in the MVPD market by coercing MDU owners and managers into perpetual contracts and by engaging in predatory pricing when potential competitors enter the market. Opening franchised cable operators’ perpetual contracts through application of the “fresh look”

¹⁵ See Competition in the Interstate Interexchange Marketplace, 7 FCC Rcd at 2682; Expanded Interconnection with Local Tel. Co. Facilities, 8 FCC Rcd at 7348.

¹⁶ 47 U.S.C. § 257(a).

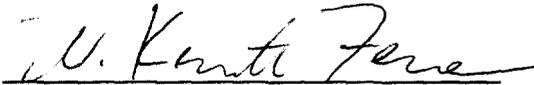
¹⁷ NOL ¶ 21.

¹⁸ See OpTel, Inc. v. Century Communications, Inc., File No. CSR-4736-P.

doctrine and retaining and enforcing regulatory prohibitions against predatory pricing or discriminatory programming practices will help to foster the growth of competition in the video programming market.

Respectfully submitted,

OPTEL, INC.

A handwritten signature in cursive script, appearing to read "H. Kenneth Ferree", written over a horizontal line.

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