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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

February 6, 1997

VIA HAND DELIVERY

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
Room 222
1919 M Street, N.W.
Washington, D.C. 20554

Re: *Ex parte* Presentation in CS Dkt. No. 95-184.

Dear Mr. Caton:

I am hereby submitting an original and one copy of this notice of the Independent Cable & Telecommunications Association ("ICTA") of an *ex parte* presentation in the above-referenced docket.

On January 31, 1997, in my role as ICTA's outside General Counsel, I met with Commissioner Rachelle Chong and Suzanne Toller, Legal Advisor to Commissioner Chong.

In this meeting, the parties discussed how the Commission can revise the inside wiring rules to encourage full competition in the local market for distribution of multichannel video programming services to residential multiple dwelling units ("MDUs"). The parties debated whether the Commission should establish the MDU owner or the tenant as the fulcrum of competition. The parties also discussed the merits of Time Warner's proposal to prohibit enforcement of existing

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exclusive contracts and to relegate its competitors to the status of lessees of inside wiring. The specific points raised by ICTA are set forth in the attached briefing points.

Sincerely,

Deborah C. Costlow

Deborah C. Costlow

Attachment

cc: Commissioner Rachelle Chong
Suzanne Toller

I. In Deciding Whether To Prohibit Exclusive Contracts, The Commission Must Analyze The Effects Of Such Contracts On A Market-Wide Basis.

- The Commission has thus far viewed each MDU as a discrete market in which all providers compete in isolation from the rest of the market and has analyzed the effects of exclusive contracts in that context. This perspective is unrealistic given that one MDU cannot support competition among all of the providers that operate in a typical market. Also, it ignores the fact that, due to the economic factors discussed below, most alternative providers will not enter a property if it is already being served by another provider.

- The relevant geographic market for the distribution of multichannel video programming services is coextensive with the franchise area, which usually extends throughout the incorporated area of a city or county. While exclusive contracts may prevent a provider from offering its services at a particular MDU, they do not prevent a provider from entering the market as a whole and competing "at the property line."

- Such a market-wide analysis is consistent with the Commission's approach in other areas, such as in determinations of effective competition.

- Franchised cable operators face no meaningful competition yet in the distribution of multichannel video programming services to single-family homes. Although viable alternatives to franchised service exist in the MDU market and competition from alternative providers is growing, franchised operators still control more than the lion's share of this market. Through the pro-competitive effects of exclusive contracting, however, alternative providers have been able to establish, and will continue to build upon, a foothold in the market and present sustained competition to franchised operators.

II. A Market-Wide Analysis Of Exclusive Contracts Indicates That They Are Pro-Competitive.

A. Competition in the MDU market will best be advanced if the MDU owner, through the exercise of its private property rights, is allowed to determine which provider(s) will service its property and is allowed to grant a chosen provider exclusive access, <u>if appropriate</u>. Constitutional and statutory authority barriers aside, the Commission should not sacrifice the constitutional and contractual rights of MDU owners for the advancement of federal telecommunications policy and, in any event, a prohibition on exclusive contracts would actually undermine the goals of federal policy by decreasing competition.

B. As shown below, due to the small subscriber base at the typical MDU, a private cable operator requires some period of exclusivity in order to ensure a cash flow sufficient to secure financing to install its facilities and initiate service at an MDU.

- The following model is based upon a 300-unit MDU and assumes that the private operator is unable to secure exclusivity *vis-a-vis* an incumbent franchised operator currently servicing the MDU.

  - The fixed costs involved in installing a complete stand-alone system at an MDU is approximately \$500 per passing or \$150,000 total for these 300 units.

  - The average penetration for cable service at MDUs is 60%. Under the very best of circumstances, a competitor can expect to obtain 50% of those subscribers from the incumbent, or 90 subscribers, due to subscriber complacency and the resulting hesitancy to switch providers.

  - Fixed costs, spread among the 90 subscribers, would equal approximately \$1660 per subscriber.

  - Monthly gross revenue averages \$36 per subscriber in better markets, which would equal a total of \$38,880 in gross revenue for the year.

  - Cash flow equals around 35% of revenue or approximately \$13,600 per year in this model.

- The ratio between annual cash flow and fixed costs would therefore be 11 to 1. Virtually no lending institution will provide financing if this ratio is greater than 6 to 1. Also, investors will shy away from a venture where it would take over a decade to earn their money back. If the provider is allowed to provide service pursuant to an exclusive access agreement, however, subscribership and thus revenue would double and the cash flow/fixed costs ratio would be in line with lending and investment standards.

- Without exclusivity, the fixed costs per subscriber are greatly above the market average of \$1,000 per subscriber that is paid to acquire SMATV systems. Investment under these circumstances would therefore be difficult to justify since even the resale price of a subscriber would not allow recoupment of such fixed costs.

- The difficulty of entering an MDU occupied by an incumbent franchised operator without the protection of some period of exclusivity is evidenced by the fact that a negligible percentage of MDUs are currently served by more than one provider.[1/]

- With the vast majority of MDUs already serviced by franchised cable operators, a prohibition of exclusive contracting would mean that at almost all MDUs potential competitors would be unable to finance the start-up of their operations. As a result, franchised operators would be left without competitors and both MDU owners and tenants would be left without a choice of providers.

C. A reasonable period of exclusivity provides new entrants with an essential degree of protection while they recoup costs.

- Even assuming a private cable operator is protected by exclusivity, it takes approximately 5 to 6 years for that operator just to recoup the costs of installing its system, disregarding the time value of money.

- Without the protection of exclusivity, a new entrant could easily succumb to the predatory practices of the incumbent who has already recouped and can therefore easily undersell its new competitor and lure away subscribers with special promotions.

- The need of private cable operators for some reasonable period of exclusivity is no different than that experienced by franchised operators when they were starting operations and it would be inequitable to deny private operators the same protection. In a recent court case, a major franchised operator candidly stated that it initially required a period of exclusivity at a MDU because without such "there was no assurance . . . that, after spending a substantial amount of money for the purchase and installation of the cable system . . . [it would] recoup its investment." Pl.'s Mem. In Opp'n to Defs.' Mot. To Dismiss at 5, Comcast Cablevision of Arkansas, Inc. v. General Properties, Inc., et al., No. 96-5826 (Pulaski County Ct., Ark., 1996) (attached as Exhibit 1).

[1/] Time Warner's reference to MDUs in New York city served by both itself and Liberty Cable ("Liberty") as evidence of a rise in dual-provider scenarios is misleading. Most of the MDUs involved are owned by Liberty, which compensates for the competitive advantages Time Warner possesses as the incumbent. Also, those parties are competing in the nation's largest MDU market which tends to distort the economic forces at work in most other MDU markets.

- As new entrants gain sufficient overall market share, head-to-head competition at individual MDUs can be expected to increase.

D. The Supreme Court itself has recognized the pro-competitive effects of exclusive contracts. See, e.g., Jefferson Parish Hosp. v. Hyde, 466 U.S. 2, 45-46 (1983) (O'Connor, J., concurring) (exclusive arrangement between hospital and anesthesiologist firm not anti-competitive since there were many other suppliers and consumers of these services; "Exclusive dealing is an unreasonable restraint on trade only when a significant fraction of buyers or sellers are frozen out of a market by the exclusive deal."); Tampa Elec. Co. v. Nashville Coal Co., 365 U.S. 320, 335 (1961) (exclusive requirements contract beneficial to both buyer and seller).

E. At the very least there is insufficient evidence that end user choice is a more effective means of promoting competition than property owner choice. The Commission should therefore err on the side of protecting new entrants who are still struggling to gain a foothold in the market. The Commission should relocate the point of demarcation to that point where the wire is dedicated to an individual rental unit and analyze the effects of such a relocation after a few years. At that point the Commission would have a better body of evidence upon which to base its decision.

F. Thus the Commission should adopt a "fresh look" approach for any contracts that are not for an expressed term of years, *i.e.*, those that typically provide for a term "equal to the franchise and any extensions or renewals." The mere fact that a contract contains an exclusivity provision does not make it anti-competitive since providers still compete at the property line and do so at the end of each contract term. Perpetual contracts, on the other hand, foreclose any type of competition for the foreseeable future.

G. Time Warner's argument that allowance of exclusive contracting combined with relocation of the broadband demarcation point will inhibit facilities-based competition is a red herring. Time Warner has made it clear that it would not even use coaxial cable in the provision of telephone services and would instead install twisted-pair cable for that purpose. Any such argument with regard to the provision of stand-alone Internet access service is equally unconvincing. It is highly unlikely that a provider would find it economically viable to enter a property solely to provide Internet access. Furthermore, it is even less likely that an MDU owner would grant access to a provider in such circumstances when in almost all cases video and telephone service providers will already be on the property and could offer this service.

III. Time Warner's Proposal Is Anti-Competitive And Self-Serving.

- Franchised operators do not face meaningful competition with regard to single-family homes. It is only in the MDU market that viable alternatives to franchised service exist and Time Warner's proposal would smother these competitive forces just as they are taking hold.

- The proposal eliminates exclusivity only at existing properties where Time Warner and other franchised operators are entrenched and have already recouped their costs. Time Warner realizes that it will require a period of exclusivity to secure its position and recoup its costs at new-builds and therefore proposes to protect exclusivity at those properties.

- The proposal would enable Time Warner and other incumbents to remain at properties against the owners' wishes and thus is essentially a back door avenue to a federal mandatory access scheme. As discussed above, mandatory access will prevent potential competitors from obtaining financing to initiate operations and competition will effectively be eliminated. Moreover, as set forth in ICTA's formal comments in this proceeding, a federal mandatory access scheme would be unconstitutional and outside statutory authority.

- ICTA strongly opposes Time Warner's proposal to allow states to enact mandatory access schemes as they see fit. ICTA believes that such provisions are anti-competitive and should be preempted by the Commission.

  - State mandatory access laws almost always discriminate unfairly in favor of franchised cable operators by forcing property owners to grant access to those providers but not extending the same advantage to other video service providers.

  - Such laws chill competition from alternative providers since owners are reluctant to grant access to them when the franchised operator can force the owner to consent to a cumbersome overbuild.

  - These laws do not even ensure that the tenants receive cable service, since the franchised operator is not obligated to exercise its right of forced access upon a tenant request for service. Rather, the franchised operator may choose to force access only if service will be economical from that operator's perspective.

  - In the end, state mandatory access laws are simply another competitive tool for the franchised operators, which can use the provisions simply to target a competitor's subscriber base and drive it out of the market.

- As discussed above, mandatory access provisions make it economically unfeasible for alternative providers to enter a market. Indeed, ICTA polled 8 of the 10 largest private cable operators. Besides Liberty Cable, only one of those operators has significant operations in a state with a mandatory access law. As discussed earlier, Liberty Cable owns most of the MDUs at which it operates, a fact which mitigates the competitive and economic injury resulting from mandatory access.

Case No. 96-5826

IN THE CHANCERY COURT OF PULASKI COUNTY, ARKANSAS
FIRST DIVISION

COMCAST CABLEVISION OF ARKANSAS, INC. PLAINTIFF

v. 96-5826

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GENERAL PROPERTIES, INC.,
FOOTHILLS APARTMENTS LIMITED PARTNERSHIP,
FOOTHILLS ASSOCIATES,
THE CRESTWOOD COMPANY,
FOOTHILLS CORPORATION,
FOOTHILLS II APARTMENTS LIMITED PARTNERSHIP,
FOOTHILLS II ASSOCIATES,
AMERICAN TELECASTING, INC., and
AMERICAN TELECASTING OF LITTLE ROCK, INC., DEFENDANTS.
______________________________________/

MEMORANDUM OF LAW IN OPPOSITION TO DEFENDANTS' MOTION TO DISMISS COMCAST'S COMPLAINT

Plaintiff, **Comcast Cablevision of Arkansas, Inc.** (hereinafter "Comcast"), files its Memorandum of Law in Opposition to Defendants, **General Properties, Inc., Foothills Apartments Limited Partnership, Foothills Associates, the Crestwood Company, Foothills Corporation, Foothills II Apartments Limited Partnership, Foothills II Associates, American Telecasting, Inc. and American Telecasting of Little Rock, Inc.** (hereinafter collectively the Defendants), and states as follows:

I. STANDARDS FOR MOTION TO DISMISS

While Comcast does not totally disagree with the portion of the Defendants' Memorandum in Support of its Motion to Dismiss[1] concerning the legal standard for resolving a motion to dismiss, Mem at 2-3, it notes that it is clear that courts must "treat the facts alleged in the complaint as true and view them in the light

[1] Hereinafter, references to the Memorandum in Support of Defendants' Motion to Dismiss Comcast's Complaint shall be "Mem at [page number]".

> *hereto, and shall renew itself continuously for further terms of one (1) year each unless Owner or Comcast give written notice at least ninety (90) days prior to the end of the then current term.* (emphasis added)

Comcast's construction of the Easement gives full effect to both paragraphs and recognizes the difference in the terms and language of the two paragraphs. The need and wisdom for two separate provisions is well illustrated by the very circumstances of this case. *First*, it was the intent of the parties under the Easement that Comcast purchase, install and operate the cable television system at its sole cost and expense. *See* ¶¶ 1 and 10 of the Easement. *Second*, the Easement provides that Comcast agreed to provide cable service to each tenant who maintains good standing under his account, that Comcast bills the tenants directly and that the Owner of the Foothills Apartments shall not be responsible for any service charges. *See* ¶¶ 2 and 4 of the Easement. However, without the exclusive period, set forth in ¶ 5, there was no assurance under the Easement that, after spending a substantial amount of money for the purchase and installation of the cable system, anyone would subscribe and pay for Comcast's cable service or that Comcast will, at least, recoup its investment. As consideration for the substantial investment that Comcast made to improve the Foothills Apartments by installing, <u>at no charge to the owner</u>, a fully operational cable television system, the owner agreed in Paragraph 5 of the Easement to grant Comcast a period of time as the *exclusive* provider of cable service in order to give Comcast the opportunity to recoup its initial capital and labor