

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

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Federal Communications Commission
Office of Secretary

In the Matter of)
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Implementation of Section 304 of the) CS Docket No. 97-80
Telecommunications Act of 1996)
)
Commercial Availability of)
Navigation Devices)

**JOINT COMMENTS OF DIRECTV, INC.
AND HUGHES NETWORK SYSTEMS, INC.**

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DIRECTV, Inc. ("DIRECTV") and Hughes Network Systems, Inc. ("HNS") submit these comments in response to the above-referenced Notice of Proposed Rulemaking ("NPRM").

I. INTRODUCTION & SUMMARY

DIRECTV is the leading provider of direct broadcast satellite ("DBS") services in the United States.¹ DIRECTV initiated its DBS service in late 1994, and currently provides approximately 175 channels of all-digital, quality entertainment, educational, and informational programming to subscribers who have purchased a DSS[®] satellite receiving system, which features an 18-inch satellite dish antenna. DIRECTV currently serves in excess of 2.5 million subscribers nationwide. HNS is a manufacturer of home-receiving DBS satellite equipment and

¹ DIRECTV is a wholly-owned subsidiary of DIRECTV Enterprises, Inc., a licensee in the DBS service and majority-owned subsidiary of HE Holdings, Inc., a Delaware corporation.

is one of several manufacturers that have been authorized to manufacture and market DSS[®] satellite receiving equipment.²

DIRECTV and HNS submit these joint comments to urge the Commission not to undo the success that it has achieved thus far in fostering technology development and innovation through its flexible regulatory approach to DBS service. The Commission risks undoing that success entirely if it decides to regulate DBS integrated receiver decoders (“IRDs”), commonly referred to as “set-top boxes,” and satellite receive antennas, or “dishes,” under Section 629 of the Communications Act of 1934.³

Congress added Section 629 to “assure the competitive availability to consumers of converter boxes, interactive communications equipment, and other customer premises equipment from manufacturers, retailers, and other vendors not affiliated with a telecommunications operator.”⁴ Congress’s principal motivation in adopting Section 629 was to address the situation facing cable television subscribers who too often are forced to rent their converter boxes and other equipment from the monopoly cable operator at inflated rates. In contrast, DBS subscribers enjoy a broad range of equipment choices and sources. Competition already has led to significantly lower equipment prices for consumers, who today can purchase DBS equipment from a wide array of manufacturers and retailers for less than half the price of only two years ago. Given the still-nascent stage of development of the DBS marketplace, the

² HNS is also a subsidiary of HE Holdings, Inc.

³ Section 629 applies to “converter boxes, interactive communications equipment, and other equipment used by consumers to access multichannel video programming and other services offered over multichannel video programming systems” 47 U.S.C. § 629(a).

⁴ H.R. Conf. Rep. No. 104-458 (1996), at 180 (“Conference Report”).

Commission should resist using blunt regulatory instruments to address problems that do not exist.

Continued innovation is vital to DBS's growth as the most formidable competitor to incumbent cable operators in the multichannel video programming distributor ("MVPD") market. It is imperative that the Commission not take any action that might diminish the level of competition in the market today, or "freeze" DBS technology development, through over-regulation.⁵ Specifically, the Commission should not deter innovation by requiring the compulsory licensing of proprietary technology or by mandating interoperability for DBS equipment. Moreover, the Commission should not require the unbundling of the security function from DBS navigation devices because it would impede the ability of DBS providers to prevent theft of service. Finally, the Commission should not prohibit DBS providers from offering price rebates or other incentives to consumers who purchase DBS equipment.

II. DBS SHOULD NOT BE SUBJECT TO THE COMMISSION'S REGULATION OF NAVIGATION DEVICES

The DBS service currently faces intense intra- and inter-service MVPD competition, which has resulted in a dramatic decrease in the price of DBS equipment in the short time that DBS has been in operation. Commission intervention at this stage of DBS marketplace development would be counterproductive, and would undercut both the intent of Congress and the Commission's stated policy of ensuring the benefits of competition while minimizing governmental intrusion into the marketplace. The Commission can best achieve the

⁵ *Conference Report* at 181.

policies of Section 629 by adopting a hands-off approach with respect to the regulation of DBS navigation devices.

A. Competition Already Has Resulted In Dramatically Lower Prices For DBS Navigation Devices

Competition among DBS providers and among equipment manufacturers has drastically reduced the upfront equipment costs that a consumer pays to obtain DBS service.⁶ As a result of this competition, the price of DBS equipment has fallen from a low of \$597 in 1995 to around \$200 to \$300 in 1996.⁷ Today, the upfront costs are as low as \$99 in some markets.⁸ It is predicted that prices will decline even further.⁹

Because of the steep decline in equipment prices, the DBS industry has experienced one of the most successful increases in MVPD subscribership since DIRECTV first introduced high-power DBS service to the American public in late 1994.¹⁰ Because of its success, DBS has become a leading technology for the distribution of multichannel video services, and is second in subscribership only to cable,¹¹ which still continues to dominate the

⁶ *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, Third Annual Report*, CS Docket No. 96-133, FCC 96-496, at ¶ 38 (released Jan. 2, 1997) (“*Third Video Competition Report*”).

⁷ *Id.* at ¶ 43.

⁸ Reed E. Hundt, Chairman, Federal Communications Commission, *The Hard Road Ahead -- An Agenda for the FCC in 1997*, 1996 FCC LEXIS 7111, at *20 (Dec. 26, 1996).

⁹ *Third Video Competition Report* at ¶ 43.

¹⁰ *Id.* at ¶ 38.

¹¹ *Id.*

MVPD industry. In May 1995, DIRECTV and USSB combined had 580,000 subscribers.¹²

Today, DIRECTV alone has over 2.5 million.¹³

DBS has enjoyed such success precisely because it has been allowed to operate and provide service based on the demands of the marketplace and not based on the unnecessary regulation of its services. The DBS industry on its own already has fulfilled the Commission's public interest goal of "maximiz[ing] . . . consumer choice and flexibility resulting from the competitive availability of equipment."¹⁴ It, therefore, would be counterproductive for the Commission to regulate DBS navigation devices at this point.

B. Congress Did Not Intend For Section 629 To Apply To DBS Providers

In enacting Section 629, Congress was most concerned with the cable television model of distributing navigation devices. Under the cable model, equipment used to receive and display multichannel video programming is "under the sole control of the service provider and [is] available only as part of the overall service offered, generally on a lease basis."¹⁵ In addition, a subscriber in this model has no choice but to obtain a navigation device from the cable company, thus resulting in the provider having monopolistic control over the market for navigation devices.¹⁶ Thus, cable navigation devices truly are not "commercially available" from retail outlets or from any source other than the cable company.

¹² *Id.* at Appendix C.

¹³ *Id.* at ¶ 39.

¹⁴ *Implementation of Section 304 of the Telecommunications Act of 1996, Commercial Availability of Navigation Devices, Notice of Proposed Rulemaking*, CS Docket No. 97-80, FCC 97-53, at ¶ 83 (released. Feb. 20, 1997) ("NPRM").

¹⁵ *Id.* at ¶ 6.

¹⁶ The control that cable companies have over cable navigation devices is exacerbated by the fact that most cable companies also have monopoly control over the multichannel

The Senate debate on the issue of competition in the navigation devices market indicates that it was this exercise of monopoly control by cable companies that most concerned Congress. According to Senator Hollings, the purpose of Section 629 is to eliminate cable's "monopoly over set-top boxes" by allowing "consumers to purchase cable set-top boxes on a retail basis from stores."¹⁷ Senator Snowe, a co-sponsor of a predecessor bill to Section 629, observed that "consumers have absolutely no choice with respect to set-top boxes. They are forced to rent them from cable companies, often as a requirement to receiving cable signals."¹⁸ To give the consumer the ability to choose, Congress "adopt[ed] a provision designed to make cable equipment cheaper and easier to use for all consumers, who are tired of paying rent for cable converter boxes Under [Section 629], the FCC is directed to assure the competitive availability to consumers of converter boxes and other electronic equipment used to access cable video programming services."¹⁹ Thus, the debate clearly was centered on monopolistic practices by cable operators, and not by emerging MVPD competitors, when Congress enacted Section 629.

video programming in their local communities. *See Third Video Competition Report* at ¶¶ 4, 14 (finding that "incumbent franchised cable systems continue to be the primary distributors of multichannel programming," available to 97% of all television households in the United States, and serving 62.1 million subscribers as of 1995; that "[l]ocal markets for the delivery of video programming generally remain highly concentrated"; and that "structural conditions remain in place that could permit the exercise of market power by incumbent cable systems").

¹⁷ 142 Cong. Rec. S689 (daily ed. Feb. 1, 1996).

¹⁸ 141 Cong. Rec. S7992 (daily ed. June 8, 1995).

¹⁹ 142 Cong. Rec. S693 (daily ed. Feb. 1, 1996) (comments of Senator Leahy in support of Section 629).

In contrast to cable, Congress had no complaints about the market for DBS navigation devices. The DBS service has developed based upon a model for distributing navigation devices that promotes competition, not monopoly. Under the DBS model, subscribers have the ability to purchase a navigation device from tens of thousands of retail outlets.²⁰ Although DBS navigation devices generally operate in conjunction with a single DBS service provider,²¹ the subscriber also enjoys the full benefits of competition, as various manufacturers and retailers compete to attract consumers across DBS services.²² Thus, unlike the cable model, the DBS model makes DBS equipment widely “commercially available” to consumers, which has resulted in documented (and dramatic) reductions in the price of DBS equipment.

Because the competitive DBS model of equipment distribution has been so successful in providing consumers with lower prices for DBS navigation devices, it is precisely the type of model that should be left unregulated. Congress fully intended for competition to replace regulation when fully competitive markets for navigation devices had developed. Section 629(e) explicitly provides that the Commission’s regulation of a particular type of navigation device shall cease to apply when the Commission determines that:

- (1) the market for the multichannel video programming distributors is fully competitive;
- (2) the market for converter boxes, and interactive communications equipment, used in conjunction with that service is fully competitive; and
- (3) elimination of the regulations would promote competition and the public interest.

²⁰ NPRM at ¶ 7.

²¹ The DSS[®] system is used to receive programming from two DBS service providers operating from the 101° W.L. orbital location, DIRECTV and USSB.

²² Primestar, which operates in the Fixed Satellite Service, follows the cable model and not the DBS model for distributing navigation devices. NPRM at ¶ 8 n.14; see *Third Video Competition Report* at ¶ 37.

Congress realized that “[c]ompetition in the manufacturing and distribution of consumer devices has always led to innovation, lower prices, and higher quality” and that “consumers will benefit from having more choices among telecommunications subscription services arriving by various distribution sources.”²³ By including the sunset provisions in Section 629, Congress could not have stated its intent more clearly: where competition exists, regulation should not.

Consumers of DBS service *today* enjoy the benefits of competition with respect to both service providers and equipment manufacturers and retailers. The DBS sector of the MVPD market is already achieving what Section 629 was enacted to assure. Therefore, in light of Congress’s intent to end monopoly and promote competition in the navigation devices market and the highly competitive nature of the DBS market, the Commission should refrain from regulating the DBS navigation devices market.

III. FACILITATING ACCESS TO DBS TECHNOLOGY BY COMPETING MANUFACTURERS FULLY ASSURES THAT DBS EQUIPMENT IS “COMMERCIALY AVAILABLE” TO CONSUMERS

Section 629(a) requires the Commission to assure the “commercial availability” of navigation devices.²⁴ One way in which the DBS industry has assisted in making navigation devices commercially available to subscribers is by facilitating access to the underlying technology by selected manufacturers, who then design, manufacture and distribute their products to the retail market for sale to consumers. As the Commission noted in the NPRM, “the legislative history . . . does not appear to reflect any concern with this mode of operation.”²⁵ Nor

²³ H. Rep. No. 104-204 (1995), at 112 (“House Report”).

²⁴ 47 U.S.C. § 629(a).

²⁵ NPRM at ¶ 22.

should the Commission have any concern. The licensing of DBS technology to multiple manufacturers has increased, not diminished, competition in the DBS equipment market. It therefore should be preserved.

A. Facilitating Access To DBS Technology Results In Lower Prices And Higher Quality And Provides Incentives For Innovation

As the Commission itself has noted, DBS equipment is available to subscribers “from a variety of retail outlets, including large national consumer electronics retailers.”²⁶ The method for distributing DSS® receiving equipment (set-top boxes and dishes) in particular is telling. DIRECTV has authorized multiple manufacturers, including HNS, Sony Electronics, Toshiba American Consumer Products, Uniden American Corporation, Thompson Consumer Electronics, Philips Consumer Electronics, Samsung Electronics, Matsushita Electric Corporation of America, Sanyo Electric, Daewoo Electronics and Memcorp, Inc., to design, manufacture and distribute DSS® receiving equipment. DIRECTV’s authorized manufacturers “represent 17 different brands and between 40 and 50 models of product.”²⁷ These manufacturers, in turn, distribute their products to “over 26,000 retail outlets and satellite dealers.”²⁸ These include retail chains such as Best Buy, Circuit City, Sears, Sam’s Clubs, Costco, Walmart, Radio Shack, and Service Merchandise, as well as local TVRO retailers, and National Rural Telecommunications Cooperative (“NRTC”) satellite dealers. Thus, when a consumer decides to purchase a DBS navigation device, he or she will have numerous manufacturers, models and retailers from which to choose.. Clearly, this distribution method

²⁶ *Id.* at ¶ 41.

²⁷ *Id.* at n.13.

²⁸ *Id.*

fulfills Congress's desire to have navigation devices commercially available "from manufacturers, retailers, and other vendors not affiliated with any multichannel video programming distributor."²⁹

The result of this competitive environment has been "innovation, lower prices and higher quality."³⁰ As described above, the price for DBS equipment has dropped substantially over the past few years. Today, DBS subscribers can obtain equipment for as little as \$99, *i.e.*, the cost of only a few months of cable service. In addition to slashing prices, DBS competition has led to product innovation and improved quality for consumers. For example, competition has resulted in easy-to-use on-screen program guides that subscribers use to navigate the channels provided by their DBS service, as well as enhanced remote control functions and other features. Thus, because of competition, DBS subscribers today enjoy better quality service and improved functionality for a much reduced equipment purchase price.

The DBS model for distribution of navigation devices not only promotes competition in price and quality, it also preserves the commercial incentives that make product innovation possible. DBS providers and manufacturers have invested a great deal of time and money in their DBS systems. They undertook the financial risks of making such an investment because of the promise of realizing a reasonable rate of return from the use of the applicable technology for the provision of DBS service. The only way in which they can recoup their

²⁹ 47 U.S.C. § 629(a). DIRECTV has no affiliation -- even at the 10% equity level proposed by the Commission -- with any DSS® equipment manufacturers other than HNS. Moreover, although an affiliate, HNS has received no preferential treatment with respect to its authorization to manufacture DSS® equipment. In fact, Thompson Consumer Electronics and Sony were authorized to manufacture DSS® equipment well before HNS.

³⁰ *House Report* at 112.

investment and invest in further development is to retain proprietary control over their share of the underlying technology. If the Commission were to require compulsory licensing by all present and prospective holders of intellectual property rights in DBS technology to any and all future players in the DBS market,³¹ the Commission would reduce the incentive for existing and prospective DBS providers and manufacturers to invest further in innovative businesses and technologies. Furthermore, such action would encourage “free riders,” as competitors would simply wait to appropriate new technologies when they are developed by others instead of investing in research and development themselves.³² Finally, compulsory licensing would strip DBS providers of the ability to control the quality of the equipment used by their subscribers, to the subscribers’ detriment.

B. The DBS Industry’s Method Of Distribution Does Not Reduce Competition

The Commission’s concern that a DBS service provider’s control over the underlying technology could be used “to restrict the addition of other types of equipment that would facilitate the reception of service from additional satellite providers”³³ simply does not reflect the state of the market today.³⁴ With respect to direct-to-home satellite services, consumers today have a choice of five separate providers: DIRECTV, USSB, Primestar,

³¹ DIRECTV and HNS seriously question the authority of the Commission to alter patent and other proprietary rights of DBS service providers and equipment manufacturers.

³² Congress recognized the need to protect proprietary rights to encourage innovation in Section 629(c), which permits the Commission to grant waivers of the regulations promulgated under Section 629 to encourage innovation. 47 U.S.C. § 629(e).

³³ NPRM at ¶ 22.

³⁴ “[I]n implementing [Section 629], the Commission should take cognizance of the current state of the marketplace. . . .” *Conference Report* at 181.

Alphastar, and EchoStar, with ASkyB on the way.³⁵ Furthermore, because the equipment has become so inexpensive, subscribers are not “locked in” to a particular DBS provider. As a result, the “control” that DBS providers and authorized manufacturers retain over their proprietary technology does not permit them to exercise that “control” beyond what the market will bear. Market mechanisms, and not the Commission, should be, and are, the check that limits any “control” that DBS providers might otherwise exercise.³⁶

Similarly, the right of a DBS service provider to select its desired equipment manufacturers should not concern the Commission. Competition among DBS providers will ensure that prices for DBS equipment will stay at competitive levels, particularly given the inter-service pressure of competing with incumbent cable monopolists. All participants in the DBS industry have an incentive to make sure that the price for DBS equipment is competitive. The lower the price, the greater the number of subscribers the providers will gain, and the more equipment the manufacturers will sell. A DBS provider that attempts to increase profit by limiting the availability of equipment will quickly lose subscribers to providers for which the upfront equipment cost is lower. Therefore, the ability to authorize manufacturers does not in any way reduce the competition that exists in the DBS navigation devices market.³⁷

³⁵ Although Primestar and Alphastar are not true DBS services, they are “close substitutes” and are relevant for the purpose of measuring competition in the DBS industry. *See Third Video Competition Report* at ¶ 37.

³⁶ Additionally, there has been no attempt by DIRECTV or other DBS providers to use “control” over proprietary technology to restrict competition.

³⁷ Although the right to select manufacturers may work to the disadvantage of a particular competitor of current manufacturers, competitive pressures faced by the DBS industry will ensure that competition in the equipment market remains thriving.

IV. THE COMMISSION SHOULD NOT MANDATE INTEROPERABILITY WITH RESPECT TO DBS NAVIGATION DEVICES

The Commission seeks comment on the necessity of standardizing navigation devices, either by Commission fiat or by private bodies, to ensure that these devices are interoperable, *i.e.*, that they will be able to receive services from more than one MVPD system.³⁸ Section 629 does not mention interoperability. Nevertheless, the Commission is considering interoperability issues because it believes that interoperability may be necessary for “a retail market for navigation devices to develop.”³⁹ With respect to DBS service, mandating interoperability in any form is not only unnecessary because there is already a well-developed market for DBS navigation devices, but it also would prevent new products and services from emerging by raising the price of navigation devices.

A. Interoperability Is Unnecessary For The DBS Industry Because There Is Already A Fully Developed Retail Market For DBS Equipment

Interoperability is not mentioned in Section 629. Instead, the Commission has raised the issue of interoperability because it is concerned that the “lack of standardization [will create] a potential obstacle to the ability of manufacturers to produce and retailers to sell [navigation devices] that can be widely used.”⁴⁰ Thus, the Commission is considering interoperability issues because it believes that “the commercial availability of [navigation]

³⁸ The Commission also inquired about the geographic portability of navigation devices. With respect to DBS service, portability is not an issue. Because DBS providers offer full-CONUS service, a subscriber in one part of the country can move to almost anywhere in the United States and still receive the same DBS service via the set-top box and dish that he or she owns.

³⁹ NPRM at ¶ 24.

⁴⁰ *Id.* at ¶ 64.

devices would be enhanced” by interoperability.⁴¹ In the context of the DBS industry, however, this rationale simply does not apply. Today, there is a thriving commercial market for DBS navigation devices that has resulted in continuously lower prices for consumers. Thus, it is unnecessary for the Commission to seek to encourage competition through regulation.

Furthermore, the DBS marketplace is capable of promoting interoperability in appropriate situations, such as in the case of DIRECTV and USSB.⁴² Although DIRECTV and USSB currently do not offer the same programming channels, they do utilize the same technology to transmit their respective programming to subscribers. Thus, a subscriber with DSS[®] receiving equipment can subscribe to DIRECTV or USSB, or both, without purchasing new equipment.⁴³ The DIRECTV/USSB relationship makes clear that when the market determines that interoperability is efficient, interoperability will result. The market, and not the Commission, should make those decisions.

B. Mandating Interoperability Would Be Counterproductive Because It Would Result In Higher Prices And Lower Quality For Consumers And Would Stifle Innovation

Not only is the imposition of interoperability unnecessary in the DBS context, it would fail to achieve its intended benefit if implemented. The Commission is considering mandatory interoperability standards to encourage the growth of a retail market in navigation devices. In addition, two of the public interest goals that the Commission seeks to achieve are

⁴¹ *Id.* at ¶ 65.

⁴² See Gregory L. Rosston & Jeffrey S. Steinberg, Using Market-Based Spectrum Policy to Promote the Public Interest, 1997 FCC LEXIS 384, at *38 (Jan. 1997).

⁴³ Although many customers subscribe to both services, other customers subscribe only to one, since each service offers competitive types of programming, e.g. HBO on USSB versus STARZ on DIRECTV.

“the stimulation and promotion of equipment innovation, with the expectation that this will result ultimately in lower costs to consumers” and the “minimization of governmental intrusion in the equipment design and installation process to the extent feasible.”⁴⁴ Requiring interoperability for DBS service providers would prevent the Commission from achieving any of these goals.

The Commission recognizes that requiring interoperability could “restrict consumer choice to excessively costly units” because “costs are directly increased as the scope of interoperability . . . is widened.”⁴⁵ This would be especially so if the Commission required DBS, an exclusively digital system, to be interoperable with cable, which is still predominantly analog. Even requiring interoperability among DBS providers would raise prices to unacceptable levels. Today, one of the reasons that equipment manufacturers do not produce DBS equipment that can access programming from more than one DBS provider is that the cost of producing such a product would render it unmarketable. While the market may evolve to such a point that it makes economic sense to manufacture interoperable DBS equipment, it would be disastrous for the Commission to force manufacturers to produce interoperable equipment before that day arrives.

Furthermore, requiring interoperability would discourage innovation in the design of DBS equipment and the transmission of DBS programming. DBS providers and equipment manufacturers not only compete in the MVPD market based on price, but also on the quality of the service or product. If the Commission requires standardization in order to achieve interoperability, it will inevitably result in the elimination of competition based on quality. And

⁴⁴ NPRM at ¶ 83.

⁴⁵ *Id.* at ¶ 65.

DBS provides a perfect example of how the Commission's flexible regulatory approach has promoted successful quality-based competition. DBS digital video transmissions are far superior in quality to cable television offerings, and DBS providers have used this difference in quality as a major selling point. Furthermore, even within the DBS industry, there are at least two competing standards for the delivery of video programming: the DSS[®] system technology used by DIRECTV and USSB, and the Digital Video Broadcasting ("DVB") technology used by other DBS providers. These two technologies compete with respect to sound and picture quality, reliability, and many other factors. Service providers and equipment manufacturers are continually attempting to improve these technologies to entice consumers to purchase their service. The beneficiaries are consumers, who receive a better product at a lower price. If the Commission were to require standards and mandate interoperability, these benefits of competition would be lost.⁴⁶

V. THE COMMISSION SHOULD NOT MANDATE UNBUNDLING OF THE SECURITY FUNCTION FROM THE OTHER FUNCTIONS PERFORMED BY DBS NAVIGATION DEVICES

DIRECTV and HNS agree with the Commission that the "[f]ailure of access control or security systems will both interfere with incentives to produce programming for the market and . . . increase the cost of service to those who do subscribe."⁴⁷ Congress, too, was extremely concerned about service theft and prohibited the Commission from issuing regulations

⁴⁶ The Commission has adopted a policy of allowing the market to choose between competing technologies in other services. See Gregory L. Rosston & Jeffrey S. Steinberg, *Using Market-Based Spectrum Policy to Promote the Public Interest*, 1997 FCC LEXIS 384, at *32 (Jan. 1997); Reed E. Hundt, Chairman, Federal Communications Commission, *Seven Habits of Hopefully Highly Successful Deregulatory Communications Policy People*, Speech Before Royal Institute of International Affairs, London, England, 1996 FCC LEXIS 5014, at *24 (Sept. 4, 1996).

⁴⁷ NPRM at ¶ 31.

that would “jeopardize security of multichannel video programming and other services offered over multichannel video programming systems, or impede the legal rights of a provider of such services to prevent theft of service.”⁴⁸ In response to Section 629(b), the Commission has proposed that, to prevent theft of service, the security function of a navigation device be unbundled from the other functions performed by the navigation device, which would allow the MVPD to retain control over the security function.

DIRECTV and HNS are concerned that the Commission does not have adequate or accurate information about the methods by which DIRECTV and other DBS service providers protect the security of their broadcasts. The Commission apparently believes that “digital transmission systems” (which describes all DBS systems) are not as susceptible to theft as analog systems. Also, the Commission seems to believe that the security in digital broadcasts can be contained entirely in a “smart card,” which can be provided by the MVPD separately from the navigation device.⁴⁹ This analysis grossly oversimplifies the methods that DBS video providers use to protect their systems from theft of service, and any regulations promulgated on the basis of this oversimplification would certainly impede a DBS service provider’s ability to prevent theft of its service.

The integrity of a multichannel video programming system, whether analog or digital, depends on the security devices employed by the MVPD to protect its broadcast from video theft. DIRECTV employs various mechanisms to control the distribution of its programming only to those subscribers who have lawfully paid for it. These control mechanisms

⁴⁸ 47 U.S.C. § 629(b).

⁴⁹ NPRM at ¶ 30.

occur at both the programming transmission end and at the subscriber reception end, and include, but are not limited to, the use of a “smart card.” These control mechanisms are interdependent. It would be impossible for DIRECTV to prevent or correct security breaches solely through the use of “smart cards.”

Because of the interdependency of DIRECTV’s control mechanisms, it is imperative that the security function of DBS navigation devices not be separated from the other functions of these devices.⁵⁰ Furthermore, a divided architecture would prevent the hardware unification and system-level integration that have already provided, and promise to permit additional, reductions in the complexity and manufacturing costs of IRDs. These cost reductions in turn allow further reductions in equipment prices charged to consumers. If the Commission were to mandate unbundling it would force DIRECTV to experience an unacceptable risk of theft of its service, as well as result in higher costs for consumers. Neither of these results was intended by Congress in enacting Section 629.

VI. PRICE REBATES PROVIDED BY DBS PROVIDERS SHOULD NOT BE SUBJECT TO ANTI-SUBSIDY REGULATION

The anti-subsidy provision of Section 629(a) permits an MVPD to offer navigation devices to consumers as long as the price charged to consumers for these devices is

⁵⁰ In the NPRM, the Commission asked for comment about whether it should “attempt to distinguish between reception and display devices, access control and security devices, and upstream transmission devices” in determining how to proceed with regulating those devices. NPRM at ¶ 19. DIRECTV and HNS do not believe that the Commission intended to suggest that it is considering a rule to require the unbundling of the many functions performed by navigation devices. To the extent that the Commission is considering such a rule, DIRECTV and HNS wish to caution the Commission that such an unbundling may not be technically possible, and even if it were, the costs of compliance would be ruinous.

not subsidized by charges for the MVPD's service.⁵¹ Both the language of and the policies behind the anti-subsidy provision demonstrate that it was directed at preventing cable monopolists from using revenue received from captive ratepayers to subsidize the cost of cable converter boxes. Without this provision, cable companies could price their equipment below a competitive level and prevent competition from developing in the cable navigation devices market. The anti-subsidy provision is thus Congress's attempt to limit cable's ability to maintain its monopoly position.

A. The Anti-Subsidy Provision Is Directed At Regulating Monopoly Cable Operators

The type of activity to which the anti-subsidy provision applies demonstrates that it was directed primarily at incumbent cable operators that do not face effective competition in the MVPD market. Congress enacted Section 629 to encourage competition in the navigation devices market, but realized that cable monopolists could prevent such a market from developing by using subsidies to enable them to charge less than a competitive price for their navigation devices. Rate regulated cable operators could succeed with charging below market prices for converter boxes because they could recoup their subsidies through charges for cable service paid by their captive subscribers. To prevent this type of anti-competitive practice, Congress included the anti-subsidy provision in Section 629.

The anti-subsidy provision allows an MVPD to offer navigation devices to consumers only if the charge for the navigation device is "separately stated and not subsidized by charges for [the MVPD's] service."⁵² Although the anti-subsidy provision in theory applies to all

⁵¹ 47 U.S.C. § 629(a).

⁵² 47 U.S.C. § 629(a).

MVPDs, the situations in which the anti-subsidy provision have any meaning arise only in the context of monopoly cable operators. For example, the requirement that equipment charges be separately stated only makes sense where the charge for equipment and service would otherwise be bundled, such as when equipment is leased, as is the norm with cable systems. In contrast, DBS subscribers generally purchase equipment with a one-time payment, but purchase service on a monthly or annual basis.⁵³ Because of this, equipment prices are not bundled with the charge for the DBS service.

Also, the situation in which subsidization is likely to occur -- “where there is a cost-of-service regulated monopolist in one market that also competes in another market”⁵⁴ -- arises only with respect to cable. DBS, on the other hand, is not rate-regulated.

Finally, the anti-subsidy provision, by its own terms, only applies when an MVPD offers navigation devices to consumers. Conversely, it does not apply when consumers purchase their navigation devices from independent retailers. For example, a DBS subscriber generally purchases equipment not from the DBS service provider but from an independent retailer. Often, the retailer or the DBS service provider will offer a price rebate to the subscriber. These price rebates are not covered by the anti-subsidy provision, however, because the retailer and not the DBS service provider is offering the equipment to the subscriber. In contrast, cable subscribers almost always must obtain their cable converter box from the cable operator, usually on a lease

⁵³ The one exception to this today is Primestar, which follows the cable model of leasing hardware bundled with programming. Nevertheless, the prevailing industry practice is to offer consumers hardware and programming on an unbundled basis.

⁵⁴ NPRM at ¶ 38.

basis. Thus, the most likely circumstances in which the anti-subsidy provision will have any meaning arise almost exclusively in the cable market.

B. Price Rebates Should Be Permitted Because DBS Must Compete With Cable Operators That Exercise MVPD Market Power

DBS service is still a relatively young service within the MVPD market.

Although it has enjoyed immense success so far, it is still a long way from eroding the market power that cable companies retain in the MVPD market. In order to foster competition in the MVPD market as a whole, the Commission should continue to permit DBS operators to use price rebates as a method of enticing current cable subscribers to switch to DBS. As the Commission noted, price rebates are “highly effective as a competitive tool.”⁵⁵ They permit the consumer to switch to DBS service with a much lower upfront equipment payment. Reductions in equipment price have resulted in dramatic increases in subscribership in the past.⁵⁶ There is no reason to believe that further reductions will fail to produce the same result in the future.

In addition, permitting DBS providers to issue price rebates does not invoke the dangers that require the application of the anti-subsidy rule to incumbent cable systems. DBS systems are not rate-regulated; DBS service rates are set by market demand. Furthermore, DBS providers face intense competition both from each other and from other MVPD systems, especially cable. This competition prevents DBS providers from raising service rates to subsidize equipment sales. As a result, the anti-competitive conduct that Congress sought to prevent when it enacted the anti-subsidy provision simply cannot occur through the use of price rebates by DBS providers. Because price rebates promote competition with cable and do not

⁵⁵ NPRM at ¶ 42.

⁵⁶ *Third Video Competition Report* at ¶ 38.

invoke any anti-competitive concerns, the Commission should permit DBS providers to continue to offer them to new subscribers.

VII. CONCLUSION

Chairman Hundt has stated that the Commission has taken “a pro-competition deregulating policy regarding DBS, and consumers have been well-rewarded.”⁵⁷ Chairman Hundt was correct. The Commission’s pro-competition policy toward DBS has allowed the DBS industry to become cable’s most significant competitor in just three short years.

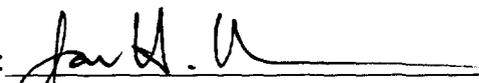
Perhaps taking a cue from the Commission, the DBS industry also has adopted a pro-competitive policy with respect to navigation devices. Instead of forcing consumers to accept equipment exclusively from the service provider, DIRECTV and most other DBS providers have allowed consumers to purchase their equipment from competing manufacturers and retailers. As expected, this vigorous competition has allowed consumers to receive the benefits of lower prices and better service. The Commission’s pro-competitive policy toward DBS regulation has been a success. The Commission should continue this success by declining to regulate DBS navigation devices under Section 629.

⁵⁷ Reed E. Hundt, Chairman, Federal Communications Commission, *The Hard Road Ahead -- An Agenda for the FCC in 1997*, 1996 FCC LEXIS 7111, at *20 (Dec. 26, 1996).

Respectfully submitted,

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