

Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, DC 20554

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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 )

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Office of Secretary

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

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## SUMMARY

DIRECTV, Inc. (“DIRECTV”) and Hughes Network Systems, Inc. (“HNS”) urge the Commission to exempt DBS equipment from the rules adopted in this proceeding. Section 629 empowers the Commission to assure “commercial availability.” It does not require the Commission to regulate DBS equipment, which already is commercially available. Likewise, the Commission should reject arguments that “regulatory parity” requires equal regulation of DBS and cable equipment. Nothing in Section 629 compels the Commission to treat DBS and cable equipment in the same manner. The DBS equipment market is highlighted by competition and commercial availability of equipment from independent retailers. In contrast, cable equipment generally is only available from the monopoly cable provider. The Commission should not apply the same rules to these vastly different markets.

The Commission should dismiss suggestions that the independent retailers of DSS<sup>®</sup> equipment act as agents of DIRECTV in selling such equipment to consumers. Manufacturers of DSS<sup>®</sup> equipment and the retailers of such equipment act on their own behalf when they sell DSS<sup>®</sup> dishes and set-top boxes. The decisions on how to manufacture and market the equipment are solely those of the manufacturer or retailer. Any assertion manufacturers and retailers essentially are serving as agents of DIRECTV in selling DSS<sup>®</sup> equipment is simply without legal or factual support.

Parties have proposed specific regulations for the Commission to adopt in this proceeding. Specifically, parties have proposed that the Commission mandate licensing of technology, mandate interoperability, and require separation of the security function from the

counterproductive if applied to DBS equipment because they would fail to increase the commercial availability of such equipment. At the same time, they would impose significant costs on DBS equipment. The market, and not the Commission, should determine whether these proposals make commercial sense in the DBS equipment market.

Finally, the Commission should continue to permit the use of price rebates by DBS providers. Price rebates are an important pro-competitive tool that helps increase the competition that entrenched cable monopolists face. Congress did not intend to outlaw this tool when it enacted the anti-subsidy provision. Instead, the anti-subsidy provision was intended to prevent cable incumbents exercising market power from using that market power to prevent the commercial availability of cable navigation devices. Accordingly, the Commission should limit the application of the anti-subsidy provision to cable monopolists and should disregard any attempts to apply it to DBS price rebates.

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DIRECTV, Inc. ("DIRECTV") and Hughes Network Systems, Inc. ("HNS") submit the following reply comments in the above-captioned proceeding.

**I. INTRODUCTION**

In their initial comments, DIRECTV and HNS urged 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. Specifically, DIRECTV and HNS urged the Commission to exempt DBS equipment from the regulations that will be adopted in this proceeding because the DBS equipment market already is fully competitive and because DBS equipment already is commercially available to consumers from unaffiliated manufacturers and retailers.<sup>1</sup> DIRECTV and HNS also commented on specific types of regulation that the Commission should *not* impose on DBS equipment: mandated licensing of technology,

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<sup>1</sup> Joint Comments of DIRECTV, Inc. and Hughes Network Systems, Inc. at 3-13 ("Joint Comments").

mandated interoperability, unbundling of functions, and restriction of price rebates to consumers.<sup>2</sup>

DIRECTV and HNS reiterate their position here. A decision by the Commission to regulate the currently competitive DBS equipment market will not only fail to increase the commercial availability of DBS navigation devices to consumers, but will actually decrease competition in both the equipment market and the multichannel video programming distributor (“MVPD”) market. The Commission should reject proposals submitted in this proceeding that seek to replace the invisible hand of market competition with the heavy hand of government regulation. There is no legal or policy reason for regulating DBS equipment. Thus, the Commission should exempt DBS equipment from the requirements of Section 629.

## **II. THE COMMISSION CAN AND SHOULD EXEMPT EQUIPMENT THAT IS ALREADY COMMERCIALY AVAILABLE ON A COMPETITIVE BASIS TO CONSUMERS**

Section 629 of the Communications Act provides the Commission with the authority to adopt regulations “to assure the commercial availability” of navigation devices.<sup>3</sup> Several parties state that this statutory mandate either fails to provide the Commission with the authority to exempt DBS providers from the regulations to be adopted under Section 629,<sup>4</sup> or that the Commission should regulate DBS equipment to achieve “regulatory parity” with cable or

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<sup>2</sup> Joint Comments at 13-22.

<sup>3</sup> 47 U.S.C. § 629(a).

<sup>4</sup> Comments of the National Cable Television Association at 15 (“NCTA Comments”); Comments of Time Warner Entertainment Company, L.P. at 22-25 (“Time Warner Comments”); Comments of US West at 9 (“US West Comments”).

other regulated MVPDs.<sup>5</sup> These assertions are misguided. Section 629, like the 1996 Act in general, demonstrates a preference for competition, not regulation. Where competition does not exist, the Commission can and should act to assure that navigation devices are commercially available to consumers on a competitive basis. But where competition is present, regulation serves no purpose, and will only harm competitors and consumers. DBS faces vigorous competition in *both* the equipment and the MVPD market. Most cable operators face competition in *neither*. This fact justifies exempting DBS equipment from the regulations to be adopted in this proceeding.

**A. Nothing In Section 629 Requires The Commission To Regulate Navigation Devices That Already Are Commercially Available To Consumers**

Several commenters suggest that the Commission does not have the authority to exempt DBS equipment from the regulations that will be adopted in this proceeding.<sup>6</sup> This position has no support in either the text of Section 629 or in the policies Congress sought to achieve by enacting it. The mandate of Section 629 is straightforward: “[t]he Commission shall . . . adopt regulations to assure the commercial availability . . . of . . . equipment used by consumers to access multichannel video programming . . . from manufacturers, retailers, and other vendors not affiliated with any multichannel video programming distributor.”<sup>7</sup> Thus, Section 629 clearly states the goal Congress sought to achieve – commercial availability of navigation devices from entities not affiliated with the MVPD – and provides the Commission

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<sup>5</sup> Time Warner Comments at 25; *see also* Initial Comments of Ameritech New Media, Inc. at 4 n.3 (“Ameritech Comments”).

<sup>6</sup> *See supra* note 4.

<sup>7</sup> 47 U.S.C. § 629(a).

with broad authority to achieve that goal, including the discretion to determine how best to achieve commercial availability.<sup>8</sup> This discretion authorizes the Commission to “take cognizance of the current state of the marketplace,”<sup>9</sup> *i.e.*, to determine that DBS navigation devices already are commercially available to consumers, and, consequently, to exempt DBS equipment from the requirements of Section 629.

US West, Time Warner, and the NCTA argue that the Commission does not have the authority to exempt one class of MVPDs, such as DBS, from regulation because Section 629 covers all MVPDs.<sup>10</sup> This construction has no merit. To be sure, Section 629 authorizes the Commission to regulate equipment used to access MVPD systems, which by definition includes DBS.<sup>11</sup> But simply because Section 629 provides the Commission with the legal *authority* to regulate DBS equipment if the Commission determines that such equipment is not already commercially available, it does not *require* the Commission to regulate DBS equipment. Section 629’s mandate is only that the Commission adopt regulations that assure commercial availability.

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<sup>8</sup> The only restrictions that Section 629 places on the Commission’s discretion are (1) the agency may not adopt regulations that prohibit an MVPD from also offering navigation devices that have been made commercially available to consumers if the MVPD’s price for the device is separately stated and unsubsidized by service charges, and (2) the Commission may not adopt regulations that jeopardize security of an MVPD’s system. 47 U.S.C. § 629(a), (b).

<sup>9</sup> H.R. Conf. Rep. No. 104-458 (1996), at 181 (“Conference Report”).

<sup>10</sup> US West Comments at 9; Time Warner Comments at 23; NCTA Comments at 15.

<sup>11</sup> Time Warner Comments at 23; US West Comments at 9; *see also* 47 U.S.C. § 522(13) (defining MVPD as including DBS service). DIRECTV and HNS express no opinion concerning the Commission’s authority to apply Section 629 requirements to OVS operators.

If the Commission determines that certain MVPD equipment already is commercially available, it plainly has the discretion under the statute to exempt that equipment from regulation.<sup>12</sup>

In exercising its discretion, the Commission should exempt from regulation navigation devices that already are commercially available from independent retailers on a competitive basis.<sup>13</sup> DIRECTV and HNS have already provided the Commission with a detailed description of the DBS equipment market in general and the DSS<sup>®</sup> equipment market in particular.<sup>14</sup> As the Commission has noted, “there is *abundant* competition in the manufacture of [DBS equipment, which is] readily available for consumer purchase through retail outlets.”<sup>15</sup> Furthermore, all of the manufacturers or retailers of DSS<sup>®</sup> equipment are independent entities that make their own decisions regarding the manufacturing and marketing of their equipment. Clearly, the DBS equipment market already has achieved what Section 629 requires the Commission to assure: the commercial availability of navigation devices from unaffiliated manufacturers and retailers. In light of the competition that exists in the DBS equipment market,

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<sup>12</sup> It is ironic that some of the same parties that argue that the Commission does not have the discretion to exempt DBS equipment from regulation propose that the Commission exempt all analog equipment from its Section 629 rules. See US West Comments at 2-3; NCTA Comments at 8.

<sup>13</sup> As Time Warner itself admits, “there are entire categories of consumer electronics equipment which are already marketed in a fully competitive environment, and with which the Commission need not concern itself in this proceeding.” Time Warner Comments at 21; see also Reply Comments of Ameritech New Media, Inc. at 2 n.3 (“[The] rules should be waived from equipment that already is commercially available by any reasonable measure . . . .”) (“Ameritech Reply Comments”).

<sup>14</sup> Joint Comments at 4-5, 9-12.

<sup>15</sup> *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 ¶ 22 (released Feb. 20, 1997) (“NPRM”) (emphasis added).

Commission regulation at this point would be redundant, unnecessary, and counterproductive. Therefore, the Commission should exercise its discretion and, consistent with Section 629, exempt DBS equipment from its regulations.<sup>16</sup>

**B. Regulation Is Warranted Only For Those Entities That Exercise Market Power**

The Commission received comments that argue that principles of “regulatory parity” require the application of the same rules to all MVPDs and to each equipment market.<sup>17</sup> These arguments also are meritless. Nowhere in Section 629 does Congress mention, or even suggest, that regulatory parity is an issue that the Commission should consider. Moreover, no principle of regulatory parity requires the Commission to treat radically different equipment distribution models in the same manner. To do so would lead to perverse and anticompetitive results, quite contrary to what the Commission seeks to achieve in this proceeding.

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<sup>16</sup> In the alternative, the Commission has full authority to “sunset” regulation of DBS equipment from the outset. The sunset provision provides that regulations adopted under Section 629 will no longer apply when “(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 regulation would promote competition and the public interest.” 47 U.S.C. § 629(e). Nothing in the statute requires the Commission to wait for an arbitrary period of time before it can sunset regulations where the conditions specified in the sunset provisions already are present.

<sup>17</sup> Time Warner Comments at 25; Ameritech Comments at 4 & n.3. Ameritech did not use the term “regulatory parity” but states that the Commission should “not advantage one type of MVPD over another.” *Id.*; see also NCTA Comments at 43 (Commission should not favor a particular MVPD competitor in applying sunset provision).

1. **Differences in Market Structure Require Different Regulatory Approaches**

The cable interests attempt to link the Commission's decision on whether to regulate DBS equipment with its decision on how to regulate cable equipment. Raising the banner of "regulatory parity," they claim that the Commission must regulate the MVPD market as a whole. Thus, if cable or cable equipment is regulated, these parties argue, then the Commission also must regulate DBS and DBS equipment, regardless of the differences between the DBS and cable equipment markets. For example, according to NCTA, "the current state of the competitive marketplace may not be used as an excuse to exempt DBS providers from [Section 629's] requirements while continuing to apply them to cable."<sup>18</sup> The question such comments fail to address is: Why not?

"Regulatory parity" does not mean "one size fits all." The initial hypothesis of the cable industry -- that different MVPD services and equipment markets must be subject to identical regulation -- is inherently flawed. DBS, MMDS, SMATV, and OVS each are examples of different MVPDs that, for appropriate reasons, are regulated differently from each other and from cable service. For example, the existence of market power often justifies greater regulation of a particular industry. In the MVPD market, only cable is subject to rate regulation because only cable has market power in that market.<sup>19</sup> In contrast, DBS is not subject to rate regulation because competition assures that DBS service rates remain competitive.

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<sup>18</sup> NCTA Comments at 15.

<sup>19</sup> 47 U.S.C. § 623.

Likewise, as the Commission recognized in the NPRM, the cable model for distributing navigation devices bears little resemblance to the DBS model. The cable model uses a cable-owned converter box that is leased to the subscriber in conjunction with the overall cable service.<sup>20</sup> The DBS model primarily involves customer-owned equipment that is available to the consumer through a multitude of retail outlets.<sup>21</sup> Moreover, DBS providers face intense intra- and inter-service competition, while most cable operators enjoy monopoly or near-monopoly status.

Contrary to NCTA's suggestion, the Commission cannot and should not ignore differences in the equipment and service markets of cable and non-dominant MVPDs. Instead, the Commission should "take cognizance of the current state of the marketplace,"<sup>22</sup> as Section 629 requires, in determining how best to fashion regulations to assure that navigation devices are commercially available.<sup>23</sup>

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<sup>20</sup> NPRM at ¶ 6.

<sup>21</sup> NPRM at ¶ 7, 22.

<sup>22</sup> Conference Report at 181.

<sup>23</sup> The inapplicability of the "regulatory parity" argument becomes especially evident when viewed from the context of common carrier regulation. In the common carrier context, the Commission has long subjected "dominant" carriers to a different, more rigorous regulatory regime than "nondominant" carriers. Dominant carriers are subject to price-cap regulation, while non-dominant carriers may elect rate-of-return regulation. 47 C.F.R. §§ 61.41, 65.1. Also, dominant carriers have a more rigorous tariff filing procedure than non-dominant carriers. 47 C.F.R. § 61.58. Under the theory of "regulatory parity" that some of the comments have put forth in this proceeding, the Commission has failed to achieve regulatory parity in the common carrier context because it applies different rules to dominant and non-dominant carriers. This theory of regulatory parity, of course, is nonsense. The Commission regulates dominant carriers more rigorously because dominant carriers possess market power. For the same reason, the Commission would be justified in exempting DBS equipment from regulation while applying it to cable.

The cable interests' invocation of "regulatory parity" also fails to comport with the mandate of Section 629. What Congress sought to address was the commercial availability of navigation devices. Thus, to the extent the Commission is concerned about "parity," it should measure such parity by the ability of the consumer to obtain navigation devices from independent retailers, regardless of the MVPD service to which the consumer subscribes. Currently, DBS subscribers can obtain equipment from independent retailers; cable subscribers cannot. Thus, today there is no "parity" from the consumer's perspective between DBS and cable services. The only way the Commission can achieve true "parity" is by tailoring its regulations to those MVPDs that do not distribute equipment through independent retailers, while exempting from regulation equipment distributed on a pro-competitive basis.

**2. Tying Regulation Of DBS Equipment To That Of Cable Equipment Will Have Perverse And Anticompetitive Effects**

Tying the regulation of DBS equipment to regulation of cable equipment is not only conceptually flawed, but it will actually decrease competition in the MVPD market. Any attempt to regulate DBS equipment would make DBS service less competitive in the MVPD market and further strengthen cable's market power.

The DBS equipment market already is fully competitive. Prices have dropped dramatically over the last few years, and consumers today can subscribe to DBS service for a lower upfront cost than ever before. Because DBS equipment prices already are at a competitive level, no regulatory regime imposed by the Commission will cause the price of DBS equipment to fall any further. Instead, the cost of complying with any new regulations could result in higher prices, lower quality, and less product innovation. As a result, DBS providers will be less

competitive with incumbent cable operators. DBS is the most significant competitor to cable today, and any weakening of DBS competitiveness will serve only to strengthen cable's monopoly power.<sup>24</sup>

Several parties argue that DBS equipment should remain regulated until the Commission deregulates all navigation devices,<sup>25</sup> *i.e.*, until the entire MVPD market is fully competitive.<sup>26</sup> The question that these parties fail to ask is: why is the MVPD market not fully competitive today? The answer is that the MVPD market remains dominated by cable operators. Applying the skewed logic of the cable interests, cable's *competitors* must be regulated until *cable* loses market power. Such a rule would be detrimental to the public interest by discouraging competition and rewarding the exercise of market power. The cable interests could buttress their arguments by working with the Commission to find ways to reduce cable's market power. As usual, however, they have sought here to reduce competition by proposing that the Commission restrict the ability of non-dominant MVPDs to compete. The Commission should reject their proposals as contrary to the public interest. If the MVPD market is ever to become fully competitive, the Commission should impose rules to promote competition and to prevent anticompetitive conduct by entities that exercise market power. That is the result that Congress

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<sup>24</sup> The Commission has expressed concern that, despite the emergence of new competitors, such as DBS, incumbent cable systems still possess and exercise market power. *See 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 ¶¶ 4, 14 (released Jan. 2, 1997) ("*Third Video Competition Report*"); *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, Second Annual Report*, 11 FCC Rcd 2060, at ¶¶ 194, 215 (1995).

<sup>25</sup> *See* Time Warner Comments at 48; NCTA Comments at 43; US West Comments at 19.

<sup>26</sup> *See supra* note 16.

intended with respect to navigation devices in Section 629. And that is the result the Commission should seek to achieve here by exempting DBS equipment from Section 629 regulations.

### **III. CONSUMERS PURCHASE DSS<sup>®</sup> EQUIPMENT FROM INDEPENDENT RETAILERS, NOT FROM DIRECTV.**

Ameritech states in its initial comments that a consumer who purchases equipment to access DIRECTV programming actually purchases the equipment from DIRECTV, and not from independent retailers.<sup>27</sup> Although short on analysis, Ameritech apparently concludes that retailers of DSS<sup>®</sup> equipment “essentially [are] serving as . . . agent[s] of” DIRECTV when they sell such equipment because they are “not free to act independently in setting prices or other terms and conditions of the sale.”<sup>28</sup> Ameritech does not elaborate on the reasoning behind its conclusion that “the customer is effectively making the purchase from DIRECTV.”<sup>29</sup> Nor could it. The retailers of DSS<sup>®</sup> equipment act on their own behalf, not on behalf of DIRECTV, when they sell such equipment.<sup>30</sup>

Ameritech concedes, as it must, that “[a] consumer can go to a number of retail establishments and purchase. . . a DBS dish to receive DIRECTV programming service.”<sup>31</sup> DIRECTV and HNS agree with this statement. DIRECTV and HNS, however, vehemently

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<sup>27</sup> Ameritech Comments at 9.

<sup>28</sup> *Id.* at 9 & n.9.

<sup>29</sup> *Id.* at 9.

<sup>30</sup> Even HNS, which shares a common parent with DIRECTV, acts on its own behalf and makes its own decisions regarding the manufacturing and marketing of DSS<sup>®</sup> equipment.

<sup>31</sup> *Id.* at 9.

disagree with Ameritech's unsupported and conclusory assertion that retailers of DSS<sup>®</sup> equipment act as agents of DIRECTV when they sell equipment to customers. The reality is that the manufacturers of DSS<sup>®</sup> equipment and the retailers of such equipment act on their own behalf when they sell DSS<sup>®</sup> dishes and set-top boxes. In all cases, the relationship between DIRECTV and the manufacturers of DSS<sup>®</sup> equipment is a contractual one involving the terms and conditions for use of the DSS<sup>®</sup> trademark. In addition, there may be performance-based incentives, aimed at increasing the number of subscribers, that encourage the marketing and selling of DSS<sup>®</sup> equipment. However, the decisions on how to manufacture and market the equipment are solely those of the manufacturer or retailer. Ameritech's bald assertion that manufacturers and retailers "essentially [are] serving as . . . agent[s] of" DIRECTV when they sell DSS<sup>®</sup> equipment is simply without legal or factual support.

Nor do DBS service providers such as DIRECTV have an incentive to create an agency relationship with their manufacturers and retailers for the distribution of DBS equipment. DBS service providers competing against incumbent cable monopolies have every incentive to promote widespread distribution of DBS navigational devices. By entering into contractual agreements with independent manufacturers, who then compete in the market for DBS equipment, DBS providers have helped create an equipment market in which competition drives down prices and makes equipment commercially available to consumers from independent manufacturers and retailers. This system also promotes product innovation as DBS manufacturers in competition with each other attempt to improve and differentiate their equipment. This policy is a proven success for all, resulting in lower prices to consumers and increased DBS subscribership over the past few years.

#### **IV. THE COMMISSION SHOULD NOT MANDATE TECHNOLOGY LICENSING**

Several commentators have suggested that the Commission require licensing of technology and disclosure of network information.<sup>32</sup> Once again, such rules, when applied to the DBS industry, are unnecessary. While requiring mandated licensing may be beneficial in certain settings, it is not appropriate where the market already has established a mechanism for ensuring that a competitive number of manufacturers have access to technology. For example, 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<sup>®</sup> receiving equipment. Thus, in the DBS context, DBS technology already is being developed by multiple manufacturers in a pro-competitive fashion and without the need of Commission intervention through mandated technology licensing.

#### **V. THE COMMISSION SHOULD NOT MANDATE INTEROPERABILITY OF DBS EQUIPMENT, BUT SHOULD LET THE MARKET DECIDE WHETHER MANUFACTURING AND MARKETING INTEROPERABLE DEVICES MAKES TECHNICAL AND ECONOMIC SENSE**

Several commenters suggest that the Commission should require equipment to be interoperable with either MVPDs in the same service or with all other MVPDs.<sup>33</sup> They contend

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<sup>32</sup> See, e.g., Comments of Information Technology Industry Council and the Computing Technology Industry Association at 10-14; Comments of Zenith Electronics Corporation at 12; Comments of Circuit City Stores, Inc. at 28-30; Comments of Consumer Electronics Manufacturers Association at 13-16; Consumer Electronics Retailers Coalition on Notice of Proposed Rulemaking at 29-30.

<sup>33</sup> Comments of Viacom, Inc. at 10-11 (“Viacom Comments”); Comments of Tandy Corporation at 8 (“Tandy Comments”); Circuit City Comments at 25.

that by mandating interoperability the Commission will encourage the development of a retail market for navigation devices. Nothing could be further from the truth. Not only is requiring interoperability by fiat unnecessary for the development of a retail market for navigation devices, it would be counterproductive and actually hinder the development of the market. Requests to the Commission to mandate interoperability should be disregarded, at least as they apply to markets in which competition already exists.

**A. Mandating Interoperability Will Hurt, Not Help, The Market For Navigation Devices By Increasing The Cost Of Purchasing These Devices**

Certain parties suggest two reasons for mandating interoperability of navigation devices. First, they argue that mandating interoperability will promote the commercial availability of navigation devices by allowing the consumer to purchase a single box to access various MVPDs.<sup>34</sup> Second, Viacom, in particular, supports mandated interoperability because it believes that interoperability will provide the consumer with an “unobstructed gateway to numerous and diverse programming voices.”<sup>35</sup> These parties do not point to any provision in Section 629 regarding interoperability; there is none. Nevertheless, these parties believe that the Commission’s mandate to “assure commercial availability” would justify a decision to mandate interoperability. On the contrary, mandating interoperability would not assure, but would reduce, the commercial availability of navigation devices, as well as harm competition in the MVPD programming market.

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<sup>34</sup> Viacom Comments at 11-12; Tandy Comments at 8-9; Circuit City Comments at 24-25.

<sup>35</sup> Viacom Comments at 6.

First, the best way to promote the development of a retail market for navigation devices is to allow the market to operate freely and competitively, and not to impose regulations that will increase the cost of purchasing a navigation device. Yet mandating interoperability imposes such costs. New equipment would have to be designed and tested to assure compatibility with existing (and possibly future) MVPDs, and an MVPD may have to make extensive and expensive modifications to its network. Not surprisingly, none of the commenters that support mandated interoperability engage in any significant discussion of the effect that increased costs would have on the market for navigation devices.<sup>36</sup> Once the purported benefits that interoperable devices would provide are weighed against the costs to the MVPD, the equipment manufacturer, and the consumer, the argument that mandated interoperability will promote the development of equipment markets becomes insupportable.<sup>37</sup>

Second, Viacom argues that the Commission should ensure interoperability in order to increase competition in the MVPD service market.<sup>38</sup> Mandating interoperability will, in fact, have the opposite effect by decreasing, not increasing, competition in the MVPD service market. Mandating interoperability would raise the cost of purchasing navigation devices. Because of higher costs, consumers would be less likely to subscribe to MVPDs whose primary

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<sup>36</sup> Viacom simply states that “the universal features of digital set-top boxes may add marginal costs to the price of boxes . . . .” Viacom Comments at 12.

<sup>37</sup> In its reply comments, Ameritech states that DIRECTV and HNS argue that “lack of interoperability of DBS equipment is not a problem because the prices for this equipment have fallen.” Ameritech Reply Comments at 4 n.7. While lower prices have permitted consumers to switch MVPDs more readily, DIRECTV and HNS oppose mandated interoperability primarily because it would unnecessarily raise the price for DBS equipment without achieving any corresponding benefits in the retail market for such equipment.

<sup>38</sup> *Id.* at 11.

offering involves the subscriber-ownership of equipment (*i.e.*, the DBS model). Instead, they would be more likely to choose to lease their equipment from the MVPD (*i.e.*, the cable model). Instead of encouraging consumers to switch MVPDs at will, mandating interoperability will favor an MVPD that uses the cable model to distribute navigation devices.<sup>39</sup> Thus, mandating interoperability skews the market to favor those MVPDs that distribute navigation devices using the cable model, resulting in less, not more, competition in the MVPD service market.

**B. Market Forces Can Best Determine Whether Manufacturing And Marketing Interoperative Devices Is Productive And Efficient**

The purpose of Section 629 is to enable the Commission to create a regime under which a market for navigation devices can develop, not to make decisions that properly should be made by market participants. DIRECTV and HNS are not opposed to the concept of interoperability;<sup>40</sup> they are, however, opposed to interoperability procured by regulatory fiat. One day, the cost of manufacturing interoperable equipment may drop to the point where consumers will find it beneficial to purchase such equipment. When that day arrives, the market will decide that it makes economic sense to manufacture and sell interoperable devices. But that is precisely the decision that the Commission should leave to consumers and to the market.

Perhaps in equipment markets that have not already developed, mandated interoperability can be worthwhile in promoting the development of a retail market. However, the DBS equipment market already is developed fully. Consumers today have a variety of

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<sup>39</sup> Viacom concedes that the interoperable set-top box that it proposes would have to compete with uni-purpose boxes leased or purchased from the MVPDs. *Id.* at 12-13.

<sup>40</sup> In fact, equipment used to access DIRECTV already is interoperable in that it can be used to access programming from another DBS provider - USSB.

manufacturers and retailers from which to choose. The goal of promoting the retail market for navigation devices already has been achieved in the DBS equipment market. The Commission should not now diminish that retail market by adopting unnecessary and counterproductive interoperability standards.

## **VI. THE COMMISSION SHOULD NOT REQUIRE SEPARATION OF FUNCTIONS PERFORMED BY DBS EQUIPMENT**

Section 629 prohibits the Commission from adopting regulations “which would jeopardize security of multichannel video programming and other services offered over multichannel video programming systems, or impede the legal right of a provider of such services to prevent theft of service.”<sup>41</sup> To accommodate this directive, the Commission has proposed to require unbundling of the security function.<sup>42</sup> The Commission has postulated that unbundling would allow the MVPD to retain control over security while allowing competing manufacturers and retailers to make navigation devices that perform the non-security-related functions of a set-top box.<sup>43</sup> Several comments support this unbundling proposal.<sup>44</sup> DIRECTV and HNS reiterate their comment that separation of the security function from the other functions in the set-top box will not adequately protect the integrity of DIRECTV’s network.<sup>45</sup> While

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<sup>41</sup> 47 U.S.C. § 629(b)

<sup>42</sup> NPRM at ¶ 72.

<sup>43</sup> *Id.*

<sup>44</sup> *See, e.g.*, Comments of GTE at 7 (“GTE Comments”); Comments of Zenith Electronics Corporation at 13 (“Zenith Comments”); Comments of the Consumer Electronics Manufacturers Association at 17-18 (“CEMA Comments”); Comments of Circuit City Stores, Inc. at 30-33 (“Circuit City Comments”); Comments of Viacom, Inc. at 15-18 (“Viacom Comments”); Comments of Tandy Corporation at 13 (“Tandy Comments”); Time Warner Comments at 10.

<sup>45</sup> Joint Comments at 16-18.

unbundling of the security function may be the only solution that will both assure commercial availability and protect system integrity in some markets, it is completely unwarranted with respect to the DBS industry.

DBS service providers protect their systems against theft of service through the use of various security devices. For example, while “smart cards” are an important component of DIRECTV’s security system, they are not the exclusive component. Smart cards operate in conjunction with other security control devices, including hardware components in the set-top box. These security devices are interdependent. Moreover, in the DBS context, unbundling is not necessary to achieve the twin goals of commercial availability and protection of network security because DBS providers already have achieved both.<sup>46</sup> Therefore, the Commission should refrain from applying any unbundling requirements to the DBS industry.<sup>47</sup>

#### **VII. PRICE REBATES OFFERED BY DBS PROVIDERS TO SUBSCRIBERS DO NOT RAISE THE CONCERNS THAT CONGRESS SOUGHT TO ADDRESS IN THE ANTI-SUBSIDY PROVISION**

Several parties raise questions about the price rebates that are offered by DBS providers to subscribers who purchase DBS equipment,<sup>48</sup> suggesting that price rebates are anti-

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<sup>46</sup> Contrary to Ameritech’s suggestion in its reply comments, DIRECTV and HNS express no opinion about a requirement to make cable equipment available at retail or to require unbundling of cable equipment. *See* Ameritech Reply Comments at 3. To the extent the Commission seeks to impose unbundling requirements or any other requirements on DBS equipment, DIRECTV and HNS oppose such action as unnecessary and counterproductive.

<sup>47</sup> Similarly, the Commission should reject any other proposals that would compel any other unbundling of set-top box functions. In the DBS context, any required unbundling simply would impose unnecessary costs without increasing the commercial availability of DBS equipment.

<sup>48</sup> Time Warner Comments at 44, NCTA Comments at 40, US West Comments at 16, Tandy Comments at 15.

competitive and a type of “subsidy” that Congress intend to prevent with the anti-subsidy provision of Section 629. These commentators do not, and cannot, support their argument with any legal or economic justification. The Commission should reject their proposals outright.

**A. Congress Did Not Intend For The Anti-Subsidy Provision To Apply To Price Rebates Offered By DBS Providers.**

It is simply wrong to suggest, as some parties do, that price rebates offered by DBS providers to new subscribers towards the purchase of DBS equipment is the type of “subsidy” that Congress intended to prevent in the anti-subsidy provision. First of all, the anti-subsidy provision only applies when the MVPD offers equipment to the consumer. Since DBS equipment is generally offered to the consumer through independent retailers, the anti-subsidy provision does not apply at all to DBS providers.<sup>49</sup> Second, the Commission itself has noted that price rebates are “highly effective as a competitive tool.”<sup>50</sup> Given the pro-competitive purpose of Section 629, it is unlikely these price rebates are the “type of subsidies Congress was concerned about.”<sup>51</sup>

Moreover, the legislative history of Section 629 demonstrates that Congress did not intend to prohibit price rebates in markets that were fully competitive. As Senator Burns pointed out in his colloquy with Senator Faircloth, “[t]he bill’s prohibition on bundling and subsidization no longer applies when cable rates are deregulated.”<sup>52</sup> Thus, *even cable* may offer

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<sup>49</sup> Primestar, a Fixed Satellite Service system, offers its equipment directly to subscribers on a lease basis. NPRM at ¶ 8 n.14; see *Third Video Competition Report* at ¶ 37.

<sup>50</sup> NPRM at ¶ 42.

<sup>51</sup> Time Warner Comments at 45.

<sup>52</sup> 142 Cong. Rec. S700 (daily ed. Feb. 1, 1996).

price rebates to subscribers if and when cable services and the cable equipment markets are subject to effective competition. Because the DBS industry is subject to effective competition now, both in the MVPD and in the equipment markets, any suggestion that the Commission restrict the ability of DBS providers to offer price rebates to subscribers should be rejected as outside the scope of Section 629's anti-subsidy provision.

**B. Cable's Market Power Justifies Limiting The Effect Of The Anti-subsidy Provision To Monopoly Cable Operators**

Contrary to Time Warner's assertion, Congress was not concerned about the programming contracts that DBS subscribers entered into to receive a price rebate. These contracts increase, not decrease, competition in the MVPD market by providing consumers with a viable alternative to cable. As the Commission noted in the NPRM, "Congress was concerned that *regulated MVPDs with market power in programming distribution* could use that power, through equipment cost subsidization, to frustrate competition in the equipment market."<sup>53</sup> The Commission recognizes that "such subsidization is most likely to occur in a situation where there is a cost-of-service regulated monopolist in one market that also competes in another market."<sup>54</sup> For this reason, there has only been one MVPD that has been subject to rate regulation and "at cost" equipment regulation: cable. It is for this reason that Congress included the anti-subsidy provision as part of Section 629, *i.e.*, to prevent the cable industry from thwarting competition by subsidizing equipment prices.

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<sup>53</sup> NPRM at ¶ 38 (emphasis added).

<sup>54</sup> *Id.*

DBS, on the other hand, has never been subject to rate or equipment cost regulation because its rates are “regulated” by competition in the MVPD marketplace. Because DBS faces competition, it cannot “subsidize” equipment prices through its service charges. Competition forces DBS service rates to remain at a competitive level, regardless of the size of a price rebate.<sup>55</sup>

To the extent that the Commission seeks to encourage competition in the MVPD market, it should continue to permit the use of price rebates by non-dominant MVPDs. DBS providers must not only compete with each other, but also with incumbent cable monopolists. Price rebates are a useful competitive tool that allow DBS providers to obtain subscribers by reducing the upfront equipment costs that DBS subscribers must pay. Price rebates have been instrumental in the success that DBS has enjoyed over the last few years. The Commission has never expressed any concern about the use of price rebates by DBS providers, and it should not do so now. DBS price rebates present no threat to competition in either the MVPD provider market or the navigation devices market. The only threat they pose is to the market power of incumbent cable monopolists, which is why the cable interests are seeking to preclude their use. For these reasons, the Commission should continue to support competition and allow the use of price rebates by DBS.

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<sup>55</sup> Nor does the Commission need to waste its time and money on a “detailed cost of service” proceeding with respect to DBS price rebates. *See* US West Comments at 16. The recognized laws of competition satisfactorily demonstrate that DBS service providers do not “subsidize” equipment prices through increased service charges.