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

In the Matter of	)	
	)	
Annual Assessment of the Status of	)	CS Docket No. 97-141
Competition in the Markets for the	)	
Delivery of Video Programming	)	

DOCKET FILE COPY ORIGINAL

COMMENTS OF THE NATIONAL CABLE TELEVISION ASSOCIATION

Gregory L. Klein
Director of Economic & Policy Analysis

Meriem Faidi
Legal Intern

Daniel L. Brenner
Neal M. Goldberg
David L. Nicoll
Loretta P. Polk
1724 Massachusetts Avenue, N.W.
Washington, D.C. 20036
202-775-3664

Counsel for the National Cable Television Association, Inc.

July 23, 1997

TABLE OF CONTENTS

Table of Contents cont'd.

APPENDIX A:

APPENDIX B:

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

In the Matter of	)	
	)	
Annual Assessment of the Status of	)	CS Docket No. 97-141
Competition in the Markets for the	)	
Delivery of Video Programming	)	

COMMENTS OF THE NATIONAL CABLE TELEVISION ASSOCIATION

The National Cable Television Association ("NCTA"), by its attorneys, submits the following comments in response to the Commission's Notice of Inquiry ("Notice") in Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming, FCC 97-194, rel. June 6, 1997.

INTRODUCTION AND SUMMARY

In the past year, the nation's television households have experienced a steady, irreversible increase in video choices -- continuing the trend the Commission identified in its 1996 Competition Report. These increased choices come about because of a dramatically more competitive market, as satellite, telephone and other providers continue to step up their efforts to provide multichannel video programming.

The numbers bear this out. From September 1996 to May 1997, cable's share of multichannel video homes declined from 89% to 87%. In vivid contrast, cable's most significant multichannel competitor, DBS, had a subscriber growth rate of 84.5% from May 1996 to May 1997 -- nearly 34 times as great as cable's. Likewise, MMDS and SMATV subscribership increased 27% during this same period. And well over a million households either have access to a competitive multichannel choice from a telephone company or will have a choice within the next 12 months.

These growth rates make it absolutely clear that competition to cable has arrived. And they suggest that competitive forces, not market power, best explain the pricing and service behavior of today's cable operators. As explained in the Report of Economists Inc. ("Report"), accompanying these Comments in Appendix B, cable operators are performing as economic theory would predict of an incumbent facing strong competition from new entrants. Actual and potential competition generated by DBS and others has prompted cable operators to expand service and to speed network upgrades leading to improved picture quality, digital services, and broadband Internet access.

From 1995 to 1996, operators expanded cable service, growing channel capacity on average from 47 to 53 channels. Cable operators are rebuilding plant to improve signal quality and offer advanced services. Over $5.1 billion in capital expenditures were made in 1996 alone on overall revenues of $28 billion. Cable operators are also increasing the quality of program tiers by adding services, supporting networks that develop more original programming, and repositioning pay services to compete with the line-ups of competitors.

By taking these actions, as the Report describes, the cable industry is following a pattern observed in other industries, such as the automobile and retailing industries, where the incumbent responds to an innovative new entrant. Cable operators are significantly affected by -- and are reacting competitively to -- the behavior of DBS operators in particular, even though the latter may have a relatively small market share.

This competitive multichannel marketplace also constrains and redirects the pricing strategies of cable operators. Prior to the 1992 Act, some cable operators might have increased retail prices without having to demonstrate increased value. That has all changed. Market forces have overtaken what remained of market power. Already under the constraints of the Commission's rate regulation regime, cable companies can increase prices only by adding value for the customer. If not, they risk losing customers. Price increases, as a rule then, are linked to programming, technology, and service improvements.

Product differentiation by DBS and other multichannel video providers ("MVPDs") plays the significant role in multichannel video competition. DBS has a technological and capacity head start over cable operators by delivering digital video programming. By utilizing their larger number of channels available due to regulatory and technological factors, DBS companies are marketing packages of programming not available to cable operators or their subscribers.

Broadcasters also are not standing still. MVPDs and established programmers are facing new competition from off-air service. Ten years ago there were three commercial broadcast networks. Today there are six, plus public television. This array of over-the-air service places an additional, subscription-free option in the video marketplace that needs to be accounted for, particularly as broadcasters begin to introduce new digital services.

Some may argue that if the video marketplace were truly competitive, cable companies would irretrievably lose, not gain, customers. But that analysis assumes that cable operators have not responded effectively to more competition. It ignores the cable industry's successful efforts to improve customer service, to add capacity, and to restructure program packages. Recognizing that the cable industry cut its teeth as an aggressive competitor to the broadcast oligopoly, it should not be surprising to see cable respond effectively to a new competitive environment.

Cable's competitive response has not been based on a platform of increased concentration in the video industry. Today's level of horizontal concentration in the MVPD industry remains low; and what increases have occurred reflect the need of cable multiple system operators ("MSOs") to gain the operating economies and efficiencies of regional clustering to compete in a wide array of services.

Moreover, vertical concentration has decreased dramatically. Today ten of the top 20 cable networks in terms of subscribers have no ownership affiliation with a cable MSO. And four of the top seven networks by primetime ratings are non-vertically integrated.

These developments stand in stark contrast to the competitive circumstances faced by local telcos. <u>Today the cable and local telephone markets bear no resemblance to each other</u>. The federal government's video competition policies <u>are</u> working. Its telephone policies, in contrast, have <u>not</u> loosened the telcos' hold on the local telephone market. By the time the Commission issues its Fourth Report, the subscriber base of cable's facilities-based competitors should exceed 10 million -- virtually 100% of TV households will have a potential video choice from DBS or others. How many residential telephone customers will have a facilities-based choice, let alone have selected the competitor over the incumbent?

The MVPD marketplace is competitive, is on the road to even more competition, and there is no turning back. Consumers have more, and more aggressively marketed, MVPD choices. Cable's principal competitors are growing at a rate nearly 34 times faster than cable. And cable operators are responding with a price-value offering that brings real benefits to those who choose to continue to be subscribers. Cable operators really have no other choice because video customers now have other choices.

I. CABLE COMPANIES FACE GROWING ACTUAL AND POTENTIAL COMPETITION

A. Measured in Terms of Multichannel Options and MVPD Market Share, Competition is Growing

The developments of the last year continue a trend the Commission acknowledged in the Third Annual Report. Earlier this year, the Commission found that "non-cable MVPD subscribership has been increasing an average of 22% per year since 1990, with cable subscribership currently down to 89% of all MVPD subscribers."[1] As of May 1997 that number has declined to 87%.[2]

The Commission found in its last report that "incumbent franchised cable systems continue to be the primary distributors of multichannel video programming" but acknowledged that other MVPDs, particularly those using alternative technologies (e.g., DBS, wireless cable and SMATV systems), continue to increase their share of subscribers in many markets.[3] Since September 1996, the number of consumers using a noncable MVPD has grown to 9.5 million.

The substantial competition faced by cable operators contrasts sharply with the near total absence of competition experienced by local telephone companies. As detailed below, cable operators compete for video service with DBS, SMATVs, MMDS, OVS and telephone company overbuilds. Our best estimate is that by year-end 1997, more than 10 million subscribers will obtain multichannel video services from sources other than the incumbent cable operator. More

---

1 Annual Assessment of Competition in the Market for the Delivery of Video Programming, FCC 96-496, rel. Jan. 2, 1997, at 5 ("1996 Report").

2 In May, 1997, there were approximately 74.5 million multichannel subscribers, 65 million cable subscribers, or 87.2%, and 9.5 million noncable multichannel customers.

3 1996 Report at ¶5. Section 628 (g) of the Communications Act of 1934, as amended, directs the Commission to "annually report to Congress on the status of competition in the market for the delivery of video programming."

importantly, nearly all consumers have a choice between the incumbent cable operator and one or more competitors.

By contrast, local telephone companies face very little facilities-based competition for residential customers. Few residential customers can choose among providers, nearly 18 months after Congress eliminated statutory and regulatory barriers to local telephone competition.

There is no single generally accepted measure of the state of competition faced by cable companies, or of year-to-year trends. Therefore, we urge the Commission to rely upon all of the information presented in this proceeding, including objective and subjective measures and anecdotal evidence, to make its assessments about competition. As we show below, the growth of competition to cable is compellingly demonstrated by the growth in multichannel options and the growth in market share of cable's multichannel competitors.

B. DBS and Other MVPD Growth

Consumers have choices among multichannel video service providers. While cable service is available to approximately 97% of all television households (and taken by 67.2%), DBS service is generally available to all single-family residences. And many residents of multiple dwelling units ("MDUs") can elect SMATV service and in many areas, MMDS or DBS service. So there are actual or potential cable competitors everywhere for virtually every consumer.

1. DBS is particularly thriving. It is frequently observed that DBS is an unparalleled consumer phenomenon in terms of growth:

> "There's going to be some form of dish on probably 80% of the homes in America in 10 years, probably less."[4]
>
> "It [DBS] is the most successful launch of a major product in consumer electronics history. It is so far beyond VCR sales, it isn't worth talking about."[5] And,
>
> "First year sales [of DBS dishes] have been stronger than those of any other consumer electronics product in history, including VCRs, CD players and big-screen televisions."[6]

DBS subscribership grew 2.66 million to 4.91 million between May 1996 and May 1997. This amounts to an 84.5% growth rate. DirecTV and United States Satellite Broadcasting ("USSB") alone added 1.05 million subscribers during this period. The rate of growth in 1997 is even higher than in 1995 and 1996.[7] DBS Digest "projects that 7.2 to 7.8 million households will subscribe to DBS by year's end."[8] This projection is not surprising given the rate of growth DBS has experienced since its inception. (See Chart 1 below.)

---

4 Fortuna Communications publisher George Bryant, "The Dish on Satellite TV," San Francisco Examiner and Chronicle, February 5, 1995.

5 Electronics Magazine editor Bob Gerson, "Viewers Tuning in New Satellite TV," Chicago Tribune, December 27, 1994.

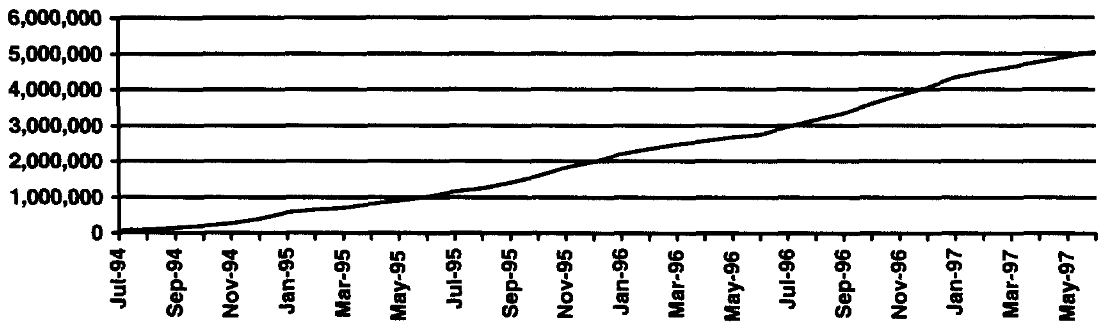
6 "Pizza-Sized Dish is the Hottest Item on Home Telecommunications Menu," Washington Times, February 4, 1995.

7 During the first five months of 1997, DBS subscribers increased 741,000. By comparison during the first five months of 1996, subscribership increased by 546,000 and in 1995 by 445,000. See Cable World, July 7, 1997, at 17.

8 Id.

CHART 1

DBS SUBSCRIBER GROWTH: JULY 1994 - JUNE 1997



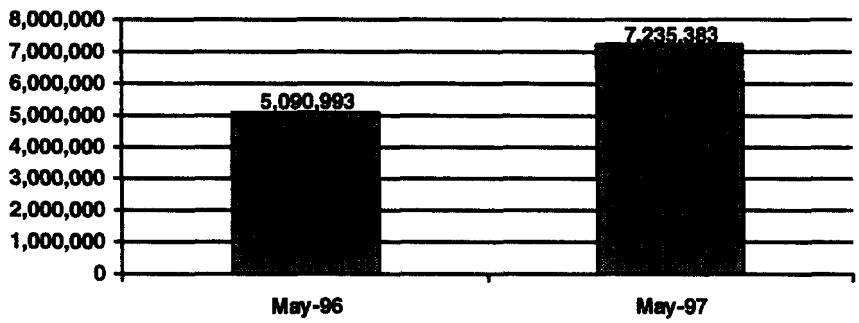
Source: Media Business Corp., SkyREPORT in 1996.

According to the SkyREPORT Newsletter, Direct-to-Home ("DTH"), i.e., all dish customers, including DBS and C-Band subscribership, grew from about 5.1 million to 7.2 million, an increase of 42%, from May 1996 to May 1997.[9] (See Chart 2 below.)

[9] SkyREPORT, June 1997. DTH includes C-Band subscribers (roughly 2 million). It should be noted that virtually all of the growth in DTH subscribership over the past three years is attributable to DBS, given that C-Band subscribership has remained relatively flat.

CHART 2

DTH SUBSCRIBERSHIP: MAY 1996 AND MAY 1997



DTH subscribers increased an additional 182,089 in June 1997, to its current total of about 7.4 million.

Growing numbers of consumers are taking advantage of these options in ways that have a real impact in the marketplace. Aggregate national numbers tell only part of the story. In 24 states, DTH satellite subscribership is now over 10% of all television homes. (See Table 1 below.)

TABLE 1

STATES WITH AT LEAST 10% DTH PENETRATION

STATE	DTH PENETRATION
MONTANA	23.52%
VERMONT	22.08%
WYOMING	18.48%
MISSISSIPPI	15.79%
MAINE	15.64%
ARKANSAS	14.52%
SOUTH DAKOTA	13.84%
IDAHO	13.81%
WEST VIRGINIA	13.81%
NORTH CAROLINA	13.76%
ALABAMA	13.65%
KENTUCKY	13.06%
SOUTH CAROLINA	12.64%
NORTH DAKOTA	12.36%
TENNESSEE	12.15%
MISSOURI	11.19%
UTAH	11.02%
INDIANA	10.78%
IOWA	10.68%
GEORGIA	10.62%
NEW MEXICO	10.57%
NEBRASKA	10.46%
OREGON	10.20%
KANSAS	10.04%

Source: Media Business Corp., SkyTRENDS, July, 17, 1997. Data as of July 1, 1997.

While this level may not yet technically satisfy the statute's effective competition test, it has proved more than sufficient to place real competitive pressures on cable operators.

The continuing growth in the number of programming networks available from DBS also demonstrates expanding competition in the MVPD marketplace. The availability of more than 100 DBS channels fosters the viability of new networks and enables these networks to market their services to consumers nationwide and, in many cases, worldwide.

DBS providers have a distinct competitive advantage over cable operators in light of regulatory and technical factors, notably additional capacity. Subscribers to DirectTV, and its companion service USSB, have access to up to 220 channels, including 34 movie channels, 30 sports channels, 27 variety channels, 16 news and information channels, 6 music channels, 68 pay-per-view channels and 31 audio channels.[10] The average cable system has 53 channels.

Prices for high-power DBS receiving equipment have fallen dramatically since DBS was first introduced to the American public. The Commission has traced this trend in its various annual reports on the status of video competition. In its First Annual Report to Congress, released shortly after the institution of DBS service, the Commission reported that DBS dishes -- which were then used in conjunction with DirecTV and USSB, the only high-power DBS providers at the time -- cost $699, and subscribers also had to pay $150-$200 for professional installation or purchase the installation equipment for $69.95.[11]

One year later, in its Second Annual Report, the Commission observed that the DBS receiving system available from RCA was then available for $597.[12] And last year, the Commission reported that when EchoStar began service, it offered receiving equipment for $199 to customers who signed up for a year's programming. In addition, two DSS manufacturers lowered their prices for their basic models to $399 and DirecTV began a $200 rebate program for subscribers who purchased a year's worth of programming.[13]

This trend has continued. On June 1, 1997 EchoStar "unbundled" its programming from its receiving equipment so that its customers did not have to purchase a year's worth of

---

10 See infra n.19.

11 1994 Report, 9 FCC Rcd 7442, 7475 (1994).

12 1995 Report, 11 FCC Rcd 2060, 2085 (1995).

13 1996 Report, FCC 96-496 at ¶43.

programming in order to purchase the EchoStar dish for $199.[14] DirecTV recently adopted the same pricing policy.[15] It seems likely that this trend in price reductions for DBS receiving equipment will continue.

At the same time that prices for basic DBS receiving equipment have steeply declined, a series of initiatives have been announced to make equipment with additional features available to the public. For example, at least two manufacturers have integrated an off-air antenna into a DBS receiving dish so that DBS subscribers may be able to receive local broadcast signals.[16] And, just last week, Hughes Networks Systems introduced an antenna called DirectDuo that can receive both the DBS programming packages of DirecTV and USSB as well as the high-speed data services of DirecPC. Existing subscribers to either DirecTV or DirectPC can upgrade to DirectDuo for between $599 and $699, while new subscribers can purchase the new antenna for $899 to $999.[17] Given the history of DBS dish prices, the prices for this TV/PC service can be expected to fall in the near future.

Ku-Band satellites operated by DirectTV and EchoStar offer customers a package of services that nearly always exceeds in number of channels the services available from incumbent cable operators.[18] The presence of multiple DBS operators affords consumer choices among full-fledged DBS competitors with cable.

---

14 "A Mixed Bag for DBS," Broadcasting & Cable, June 9, 1997, at 42.

15 Satellite News, June 16, 1997.

16 See, "A Solution for DBS' Local Signal Blind Spot?", Cable World, July 21, 1997, at 64, and "Antenna America Licensed by DirecTV," Cable World, July 21, 1997, at 8.

17 "New Dish," Cable World, July 21, 1997, at 18.

18 The DirecTV programming options include the following services: AMC, Encore, Encore-West, Encore 2-Love Stories, Encore3-Westerns, Encore 4-Mysteries, Encore 5-Action, Encore 6-True Stories, Encore 7-WAM!, Independent Film Channel, Starz!, Starz!-2, Starz!, Starz!-West,

2. SMATV and MMDS are also providing significant competition to cable systems. Tens of millions of consumers live in apartment buildings.[19] MDU residents can obtain multichannel video services from an incumbent cable operator and often from one or more operators of SMATV or MMDS systems. These high density buildings are the subject of vigorous competition. From May 1996 to May 1997, the number of MMDS and SMATV customers increased from 1.78 million to 2.26 million, or approximately 27%.[20] SMATV and MMDS service remains an option for residents of MDUs that many find attractive.

3. Well over a million households either have access to a competitive multichannel choice from a telephone company or will have such a choice within the next 12 months.

Starz!2-West, Romance Classics, Turner Classic Movies, CMT, MuchMusic, TNN, ESPN, ESPN2, Empire Sports Network, Fox Sports - Arizona, Fox Sports -Midwest, Fox Sports - Northwest, Fox Sports -Pittsburgh, Fox Sports -Rocky Mountain, Fox Sports -South, Fox Sports - Southwest, Fox Sports -West, Fox Sports -West 2, HTS, MSGN, NESN, PASS, SportsChannel - Chicago, SportsChannel - Cincinnati, SportsChannel - Florida, SportsChannel -New England, SportsChannel -New York, SportsChannel - Ohio, SportsChannel -Pacific, SportsChannel - Philadelphia, Sunshine Network, Classic Sports Network, The Golf Channel, Outdoor Life, SpeedVision, A&E, Animal Planet, BET, Bravo, Cartoon Network, Discovery Channel, Disney-East, Disney-West, E!, The Family Channel, The History Channel, Home & Garden TV, HSN, TLC, Sci-Fi, QVC, TBS, Trinity, TRIO, TNT, TV Food Network, USA Network, WGN, America's Health Network, Bloomberg Information TV, Channel Earth, CNBC, CNN, CNNI/CNNfn, C-SPAN, C-SPAN2, Court TV, Fox News Channel, Headline News, MSNBC, NewSport, Newsworld International, The Weather Channel and 31 channels of digital audio programming. DirecTV also offers Playboy TV and Spice *a la carte*. DirecTV also offers numerous sports programming packages including NFL Sunday Ticket, MLB Extra Innings, NBA League Pass, NHL Center Ice, ESPN Full Court (college basketball) and ESPN GamePlan (college football).

In addition to the programming available on DirecTV, USSB carries the following programming services: HBO-East, HBO- West, HBO2-EAST, HBO2-West, HBO3, HBO Family, Home Family-West, Cinemax - East, Cinemax-West, Cinemax 2, Flix, Showtime-East, Showtime-West, Showtime 2, Showtime 3, The Movie Channel-East, The Movie Channel- West, Sundance Film Channel, VH-1, MTV, M2, Comedy Central, Lifetime, Nickelodeon, Nick-at-Nite's TV Land, and All News Channel. There's simply no cable company in the U.S. today that offers this line-up of programming.

19 According to the Statistical Abstracts of the United States 1995 at 733 Table No. 1224, over 28 million people resided in multiple dwelling units with three or more units in 1993.

20 Paul Kagan Associates, Marketing New Media, May 19, 1997, at 4.

Ameritech is aggressively seeking cable franchises throughout its region. At last count, it has received authorizations to operate cable systems in 46 communities serving a population of more than 2,000,000.[21] The Southern New England Telephone Company ("SNET") began cable service and plans to serve the entire state of Connecticut.[22] GTE, through its subsidiary GTE Media Ventures, passes more than 520,000 homes in Clearwater, Florida and Ventura County, California, in competition with incumbent operators.[23] BellSouth[24] plans to operate video systems in many parts of its telephone service area. Bell Atlantic operates an OVS system in Dover Township, New Jersey, and apparently plans to offer cable service in Philadelphia in the near future.[25] And the Commission permits telcos to jointly market video service at the time a new resident applies for phone service.[26] Under these circumstances, the cable company is not likely to be the first call of a new resident; the telco will be.

While subscriber counts are not reported by these companies and are difficult to come by, it is nevertheless clear that telephone company video systems constitute an increasingly significant factor in any assessment of multichannel service competition.

---

21 Cableday, July 18, 1997, at 2.

22 "SNET Expanding Competition for Cable Subscribers," Hartford Courant, July 3, 1997.

23 "Cable Service Puts Internet Feel on GTE Subscribers' Television," LA Daily, May 10, 1997.

24 See, e.g., BellSouth Acquires Wireless Cable of Atlanta; Video Services to be Available to 900,000 Households: Yahoo PR Newswire, Feb. 12, 1997; BellSouth Agrees to Buy Wireless Cable TV Services in Nine Southern Markets," Atlanta Journal-Constitution, Mar. 20, 1997.

25 See CableFAX Daily, July 21, 1997, at 1.

26 Implementation of the Nonaccounting Safeguards of Section 271 and 272 of the Communications Act of 1934, as amended, 5 FCC Rcd 696, 782 (1996).

The presence of these choices profoundly changes the multichannel marketplace. This stands in stark contrast to the local telephone market. When a consumer orders residential telephone service, she or he does not have a choice among a number of options. The only choice is the incumbent telephone company.[27] Such is not the case with multichannel video service.[28]

4. The scope and intensity of the broadcast competition faced by cable operators has grown significantly. Where a multitude of strong off-air broadcast signals are available, the need for cable service is to assure a full complement of local broadcast channels is reduced. In 1975 there were 706 commercial stations;[29] in 1997 there are 1,193 stations on the air, a net gain of 69% more stations.[30] And cable's carriage of UHF stations, along with random access tuners, have narrowed the "UHF handicap" to the point where even major networks freely affiliate with UHF stations.

In the mid-1980's, cable operators competed principally with three national commercial broadcast networks for allegiance of television viewers. Since then, FOX affiliates have become full-fledged competitors achieving prime-time ratings that are comparable to other network affiliates. For example, for the week ending July 12, 1997, CBS achieved a prime rating of 5.9, while FOX's rating was 5.7.

---

27 Over 99% of residential telephone subscribers still have only one choice of provider.

28 In addition, the proliferation of the Internet as a consumer service, with video capability although small today, should be taken into account in assessing the competitiveness of the video marketplace. Reports that web sites showing the recent Mars landing have generated over 100 million hits emphasizes the importance of the Internet as a visual communications medium.

29 Warren Publishing, Television & Cable Factbook Services, Vol. 65, at I-45.

30 Broadcasting & Cable, July 14, 1997, at 66.

Cable operators are also pressed by competition from affiliates of two new broadcast networks, "The WB" and UPN, which developed due in part to the increase in licensed TV stations. Cable operators and programmers thus face off-air competition from six commercial broadcast networks, rather than three or four, in many markets. Affiliated with two of the leading production studios, "The WB" and UPN have ready access to original programming. Despite the early stage of these networks' development, they already achieve average prime-time ratings in excess of any cable network. The two networks garnered equal 11 shares.[31]

Overall, we believe the Commission can reach only one conclusion: that this level of alternatives to cable provides significant competition to the cable industry. The MVPD video market share enjoyed by cable's rivals would certainly be greater if cable companies had been so foolish as to fail to respond to the competition. During the same period that DBS and other services have grown by more than 2.3 million, cable subscribership has also markedly increased. From May 1996 to May 1997, 1.6 million new customers have reportedly signed on to receive cable service.[32]

While some of this growth is due to the overall increase in TV households, two observations need to be made. First, cable is competing hard and is winning a significant group of additional customers, due to its competitive product, when compared to other multichannel viewing options. Second, despite these gains, there has been a marked slowing of cable's subscriber growth rate. In 1994-95, cable subscribership grew at a 3.9% rate; in 1996-97, the rate had declined to 2.5%.[33]

---

[31] Nielsen Media Research, as reported in The Washington Post, July 16, 1997, at D4.

[32] A.C. Nielsen, Cable Universe Estimates, May 1996, May 1997.

[33] A.C. Nielsen Cable Universe Estimates, May 1994-1997.

II. CABLE COMPANY PERFORMANCE IN SERVICE AND RATES IS CONSISTENT WITH A COMPETITIVE MODEL

In a non-competitive market, cable television could easily become a stagnant industry. But the growing competition from DBS and other multichannel video programming distributors and broadcast networks, before and after the passage of the 1996 Telecommunications Act, meant that cable could not stand still. Facing competitive pressures from media companies positioned to offer a wide range of video and non-video services, data and Internet access, cable operators have committed billions of dollars in programming and construction funds in the past year alone. That is not the behavior of an industry that is not spurred by competition.[34]

As explained more fully in the accompanying Report by Economists Inc., the steps taken by cable operators are consistent with those one would expect of a firm subject to strong competitive pressures. In order to meet new competition -- particularly from DBS -- cable operators are making substantial new investments in programming and infrastructure, which in turn puts upward pressure on prices in some markets; in others, customer prices may drop. As Economists Inc. concluded: "The literature demonstrates that, while entry and greater competition may lead to lower prices in some markets, entry and greater competition may also lead to higher prices along with higher quality in other markets. In any specific market, the directions of the effects of entry and greater competition on quality, prices, and total sales depend on consumers' preferences, costs, regulation, and other variables."[35]

---

[34] "An Assessment of Multichannel Video Competition," Report of Economists Inc., attached as Appendix B ("Report")

[35] Economists Inc. Report at 11.

A. **Rates Are Based On Programming And Network Upgrades That Benefit Consumers**

Noting that certain cable operators have raised rates in the recent past, the Commission asks:

> Are such [rate] changes attributable to debt assumed for facilities upgrade purposes, increased programming costs, simple exercise of market power, Commission rules, other factors, or combinations of factors?[36]

Although the 1996 Telecommunications Act relaxed some rate regulation, most large cable operators are subject to local oversight of basic tier rates and federal oversight of the rates charged for cable programming services (CPS). The latter will sunset in March 31, 1999.[37] Until rate regulation of the CPS tier sunsets, the Commission has authority to review any CPS rate increase complaint filed by a local franchise authority in response to customer complaints in communities accounting for 87% of the nation's cable customers. And local franchising authorities retain jurisdiction over basic tier rate adjustments. A cable operator's ability to raise rates remains, therefore, constrained by the 1992 Cable Act and the Commission's implementing rules.

The increased costs associated with existing and new programming and infrastructure investment, along with inflation and price increases held back from prior years under Commission rules, have put upward pressure on rates. But rate increases correlate with more and better cable service. In 1996, the industry invested almost $5.1 billion in construction of advanced facilities. Moreover, again in 1996, the nation's cable systems expended a record $5.6

---

36 Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming, CS Dkt. No. 97-194, FCC 97-194, rel. June 6, 1997, at 6 ("Notice of Inquiry").

37 The Telecommunications Act of 1996 deregulated "small" cable systems, which serve only 13% of the nation's cable customers.

billion on programming, an increase of nearly $700 million (or approximately 14%) over their 1995 programming expenditures ($4.9 billion).[38] As the Report states:

> [T]he increase in the quality and quantity of programming services in regulated packages offered by cable operators amounts to a repositioning of cable service in significant part in response to competition from DBS. It would not be surprising to find such a repositioning was accompanied by an increase in prices for the improved regulated packages. Consumers may be made better off when they obtain a superior product even if it has a higher price.[39]

Among the tangible benefits cable consumers have enjoyed are at least six new programming channels, representing an increase of 12%, from 47 to 53 channels, in just one year.[40] Original programming expenditures on basic cable networks are up 19% over 1995 expenditures. Almost half of basic cable network program spending is devoted to original programming.[41] Investments in programming and infrastructure mean more creative entertainment fare, more news and information coverage, and more sophisticated two-way applications. The improved quality and overall value of cable programming growth is evidenced by the increase in cable viewership and the record number of awards bestowed on cable networks over the last year, including 26 Emmys in 1996.[42]

---

38 Estimate of NCTA, based on Paul Kagan Associates data and U.S. Copyright Office data.

39 Report of Economists Inc. at 2 ("Report") (emphasis added).

40 Paul Kagan Associates, Cable TV Programming, July 31, 1996, at 1. The average cable system's capacity grew from 47 channels in 1995 to 53 channels by the end of 1996. Moreover, the majority of cable customers are served by systems serving at least 20,000 customers which typically have greater channel capacity. Therefore, while the average system has 53 channels, the average customer receives 63 channels.

41 Paul Kagan Associates, Cable TV Programming, April 30, 1997, at 7.

42 Cable networks continued to attract more viewers, increasing their viewing share in 1996 from 50% to 51% in cable homes and from 36% to 39% in total television households. NHI Monthly CSR, as reported in Cabletelevision Advertising Bureau's 1996 and 1997 Cable TV Facts at 16-17.

The cost of these desirable innovations and improvements by the cable programming industry, along with the infrastructure improvement to accommodate them, eventually must be recouped. TCI's recent price increases, for example, were driven primarily by higher wholesale costs for programming contained on regulated service tiers.[43] During the last four years, TCI experienced, on average, 15.05% annual increases in regulated programming tier costs.[44] In 1996 alone, TCI noted that the cost increases for such programming was 21.1%.[45]

Time Warner's increases in regulated tier rates over the past year are largely attributable to the company's network upgrades (52%) and inflation and programming costs (25% and 19% respectively).[46] Time Warner's capital expenditures totaled $3 billion for 1995 and 1996 for its 12.3 million subscribers and it has projected additional expenditures of $1.6 billion for 1997.[47]

MediaOne (formerly Continental Cablevision) indicated recently that its price increases between February 1996 and February 1997 were largely attributable to new and existing programming costs (40%) and rebuild/upgrade costs (40%).[48] MediaOne has accelerated its

---

43 See Background Information on TCI Cable Service Prices, June 1997; Cable Prices and Programming Costs, Chart 4, submitted by TCI to Senate Commerce Committee, April 7, 1997. Chairman Hundt acknowledged earlier this year that "it appears that the primary driver of the [consumer rate] increases is programming increases." Multichannel News, NCTA Convention Supplement, March 19, 1997, at 10.

44 According to the Bureau of Labor Statistics wholesale price index, costs for all U.S. businesses during the 1992-1996 period increased by an average of only 1.58% each year.

45 Background Information on TCI Cable Service Prices, June 1997. According to TCI, approximately 60% of its 6.8% June 1, 1997 price adjustment was the result of increased costs for regulated programming. TCI reported that the largest margin increases were in the family, sports and general programming categories (increases of 10.62%, 8.17% and 7.83% respectively).

46 Letter from Timothy Boggs to Kevin Krufky, Senate Commerce Committee, April 7, 1997.

47 Id.

48 Letter from Robert Sachs to Kevin Krufky, Senate Commerce Committee, April 8, 1997; see also Testimony of Amos B. Hostetter, Jr. on Multichannel Video Competition before The Senate Committee on Commerce, Science and Transportation, April 10, 1997.

capital spending, having already spent over half of the $1.7 billion it committed to spend by the year 2000. With projected expenditures of $654 million in 1997, MediaOne should exceed its schedule. As of the end of December 1996, MediaOne customers had on average four more channels available on regulated tiers and this number is increasing as system rebuilds are completed.[49]

Cox Communications reported that programming cost increases accounted for 59% of its rate increases for basic and CPS tiers from February 1996 to April 1997.[50] Inflation was responsible for another 36% of the rate increases, and the addition of new program services accounted for the remaining 5%. Cox has undertaken an aggressive upgrade and build-out of its systems. The company's aggregate capital spending for 1995 and 1996 was $2 billion. Its projected capital expenditures for 1997 are between $650 million and $700 million.[51]

Increased programming costs accounted for 17% of Comcast's rate increases and channel additions accounted for another 17%.[52] Comcast has also embarked on an ambitious plan to deploy high-speed data and video services via its cable delivery network.[53] Boosted by Microsoft's recent $1 billion investment, Comcast is making further headway in its effort to connect PCs and TVs in delivering broadband video, data and interactivity to homes, schools and

---

49 Id.

50 See Memorandum from Alex Netchvolodoff to Kevin Krufky, Senate Commerce Committee, April 4, 1997. The programming cost increases include 29% for prospective programming costs and 30% for past programming costs that had not yet been recovered in rates (so-called "true-up" costs).

51 Id.

52 Letter from Joseph W. Waz, Jr. to Kevin Krufky, Senate Commerce Committee, April 7, 1997.

53 Press release, "Microsoft Invests $1 Billion in Comcast Corporation," June 9, 1997.

businesses. Comcast also is implementing ten regional customer service call centers to enhance its ability to compete with the national DBS service.[54]

Even as cable prices have increased, they are still highly competitive with the rates charged by other multichannel video distributors. Monthly prices for basic cable plus CPS tier roughly comparable to DBS prices. The average monthly cable bill for basic service was $24.57 in 1996.[55] DBS Dish Network (from EchoStar) subscribers pay $26.99 per month for 50 channels (including the Disney Channel).[56] Even with these pricing patterns, have changed over the last year, the number of cable customers increased from approximately 63.5 million in May 1996 to 65 million in May 1997.[57] This increase in customers attests to the attractiveness of cable to some customers when compared to other multichannel viewing options, particularly DBS, which has been aggressively marketed nationally during the last year.

In sum, rate increases in the cable industry over the past year are directly tied to increased operating costs and investment in new consumer product and service quality improvements -- all in response to competition and all to the benefit of consumers.

---

54 In cross-marketing the company's range of services, Comcast offers its customers a central location to purchase cable, cellular and paging services, 76ers and Flyers tickets and QVC products.

55 Paul Kagan Associates, The Cable TV Financial Databook, June 1996, at 11. And cable continues to provide a sound video value measured on a per channel basis. The price per channel for basic cable service has declined since 1991 from 53 cents to 50 cents. According to the General Accounting Office's 1991 Survey of Cable Television Rates and Services, the average price-per-channel for the most popular tier of basic service was 53 cents in April 1991. United States General Accounting Office, 1991 Survey at 16.

56 EchoStar recently eliminated its requirement that new subscribers pre-pay for one year of programming. However, it increased the monthly rate for its America's Top 50 package approximately 8% from $24.99 to $26.99. In March 1997, DirecTV raised its basic package price by 13%.

57 Supra n.32.