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FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

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In the Matter of	)	
	)	
Amendment of the Commission's Rules	)	RM-9167
To Update Cable Television Regulations and	)	
Freeze Existing Cable Television Rates	)	
of 1996	)	

OPPOSITION OF NEXTLEVEL SYSTEMS, INC.

NextLevel Systems, Inc. ("NextLevel"),[1] submits the following comments in opposition to the Petition to Update Cable Television Regulations and Freeze Existing Cable Television Rates filed by the Consumers Union and the Consumer Federation of America ("Petitioners").[2]

NextLevel urges the Commission to recognize that any regulatory freeze on cable rates will harm innovation and competition. It will create disincentives to the continued development of an advanced broadband communications infrastructure. It will burden cable operators already in the process of purchasing equipment and upgrading their networks to provide advanced services and digital technology. These network upgrades, which are in the early stages of deployment, will provide cable subscribers access to

[1] Created in the strategic restructuring of General Instrument Corporation on July 28, 1997, NextLevel Systems, Inc., is a leading world supplier of high-performance network systems delivering video, voice, and Internet/data services to the cable, MMDS, telephony and satellite markets.

superior audio and video quality, advanced entertainment and features, interactive services, Internet access and telephony.

It has been the policy of both the Congress and the FCC, as well as an important goal of the current Administration, to support investment and innovation in broadband networks. In relation to these goals, the Commission has created several mechanisms that permit operators to recoup the costs of system upgrades through higher rates when necessary. For the Commission to abandon these policies at what is a time of radical change and innovation in the broadband industry will, in the end, only serve to limit the choices in services and technologies available to consumers and curtail emerging competition in telecommunications.

1. The Commission has traditionally recognized the need to promote innovation in the provision of broadband services and has adopted policies aimed at accomplishing this goal. Institution of a rate freeze on a large group of cable operators will severely retard infrastructure investment at a critical time for the industry in its transition to advanced broadband services.

Petitioners ask the Commission to do three things: (1) freeze cable rates and assure "reasonable rates" through regulation, (2) lift the stay of horizontal ownership limits, and (3) reevaluate horizontal and vertical ownership limitations and rules in light of recent consolidation in the industry.[3] NextLevel addresses only the Petitioners' request for a rate freeze, and the devastating effect such a freeze would have on the ability of cable operators to update their networks to compete with the offerings of direct broadcast satellite operators, wireless services and telephone companies.

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[2] Petition to Update Cable Television Regulations and Freeze Existing Cable Television Rates, RM-9167, MM Docket Nos. 92-264, 92-265, 92-266, filed on September 23, 1997 ("Petition").

Petitioners have narrowly focused their petition on the near-term effects of rate increases on consumers' pocketbooks, but have neglected other consumer interests. The introduction of new services, the connection of homes, schools and libraries to a broadband network capable of high-speed Internet access, as well as the benefits realized from allowing competition to take hold in the market, are all important consumer interests, as well as important public policy concerns.

Cable operators cannot begin to offer new services until their networks are capable of delivering them. These network upgrades require significant capital investment. Congress and the Commission have consistently recognized that the cost of upgrading networks and deploying new services are legitimate expenses that benefit both operators and subscribers. In Section 706 of the Telecommunications Act of 1996,[4] Congress explicitly encourages deployment of "advanced telecommunications capability to all Americans."[5] Congress instructs the Commission that if it should determine equipment to access advanced telecommunications is not being deployed in a "timely fashion," the Commission should immediately act to accelerate deployment, including removing barriers to infrastructure investment and promoting competition.[6]

Recently, Chairman Hundt testified before the U.S. House of Representatives, Committee on the Judiciary, regarding the state of competition in the cable television industry. During his opening statement, Chairman Hundt reassured Committee members by noting that the FCC is already in the process of conducting a "data survey" regarding

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[3] Petition at 2.
[4] Pub. L. No. 104-104, 110 Stat. 56 (1996) ("Telecommunications Act of 1996").
[5] Telecommunications Act of 1996 § 706(a).

cable television rates.[7] Although the Commission has not yet released any findings, the Chairman said that preliminary results have shown cable rate increases to be caused by two primary factors: higher programming costs and infrastructure upgrades.[8]

In discussing increased programming costs, Chairman Hundt said that not allowing cable operators to pass along these increases to their subscribers would jeopardize their investment in their networks and would be "bad policy." He added, "This is not [Commission] policy."[9]

With regard to current industry activity, Chairman Hundt said:

> "...the cable industry is spending a substantial amount of money in investing in infrastructure. And let me just say that the 1996 Telecommunications Act says that we want them to do that, because...we want the cable industry to invest in...providing not only video, but voice and data services. And as a country, our policy is to have the cable industry build a competing infrastructure that can...compete with the telephone industries.
>
> "And so, the second place [where] you see price increases...is the cable industry's need to raise the money to invest in its own facilities. And we at the FCC, back in 1994, told the cable industry that when that was what they were doing with their money, they could get price increases. And I don't think we did the wrong thing, because I think that you in fact are going to see coming into the market late in 1997...a range of services, voice, video and data, that will be provided by the cable industry and they are going to be very, very effective means for providing competition to the existing telephone infrastructure."[10]

A rate freeze, in addition to contradicting national policy with regard to innovation and network development, would also conflict with the Commission's work to transfer over-the-air broadcasters from analog to digital. The Congress and the FCC gave

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[6] Id. at § 706(b).
[7] Oral statement of Reed Hundt, Chairman, Federal Communications Commission, before the U.S. House of Representatives, Committee on the Judiciary, "Hearing on the State of Competition on the Cable Television Industry" (September 24, 1997) (official transcript not yet available).
[8] Id.
[9] Id.
[10] Id.

the broadcasters additional spectrum that would allow them to make the transition to digital because they did not want free over-the-air television relegated to second class, analog status in an increasingly digital, multimedia world. As broadcasters begin their transition to digital, it is important that cable's transition to digital proceed, as almost 70% of American homes receive their local broadcast signal via cable. In an entertainment industry that already includes DBS, computers and DVDs,[11] a rate freeze would slow the digital rollout plans of cable companies and harm their ability to compete.

<u>2. The Commission has crafted various regulatory mechanisms that explicitly allow for the recovery of costs associated with system upgrades. The Commission's "rate regulation formula" need not be rewritten as Petitioners assert, because expenses must be recovered or operators will have no incentive to invest in their networks.</u>

Petitioners argue that "the Commission's current regulatory formula permits monopolistic rate increases."[12] But Petitioners fail to provide any evidence for such assertions beyond the fact that rates have gone up in many systems faster than the rate of inflation. The fact that rate increases have been explained through increased programming costs, system upgrades and inflation, is ignored by Petitioners. Video programming and advanced broadband services are not static and mature products; they are dynamic, innovative products undergoing rapid change. To evaluate their costs solely

[11] DVDs, originally known as Digital Video Discs or Digital Versatile Discs, look like today's CDs, but have vastly greater storage capacity. An entire feature length film in high-quality digital video and audio can be contained on a DVD.
[12] <u>Petition</u> at n. 29.

against the average rate of inflation is a gross oversimplification of the economic forces at work in their development.[13]

The Commission has taken various steps to encourage cable operators to upgrade their systems. First, it adopted the "going forward" rules to induce operators to add new services for a reasonable markup.[14] Second, the Commission has supported system upgrades through the creation of Social Contracts with cable multiple system operators ("MSOs"). Social Contracts cover a fixed period of time and afford an MSO greater rate and packaging flexibility in exchange for agreements to improve its network and offer new services on a national basis.

Earlier this month, Comcast entered into a Social Contract in which it committed to upgrade its network so that at least 60% of its subscribers would be served by a 750 MHz system.[15] By March 31, 1999, at least 80% of Comcast subscribers will be on systems utilizing fiber optic technology and addressability.[16] In 1995, Time Warner entered into a Social Contract in which it agreed to invest $4 billion to rebuild and upgrade all of its domestic cable systems, and for which the Commission allowed Time Warner to increase the monthly rate for the most highly penetrated cable programming service tier in each system by $1 for each year of the five year contract.[17] Continental

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[13] In addition, Petitioners fail to account for the fact that if viewed on a per channel basis, cable prices may actually have *declined* over the past several years. See FCC Report on Cable Industry Prices, FCC 96-499, MM Docket No. 92-266 (released January 2, 1997), at ¶ 22.

[14] See Going Forward Order, 10 F.C.C.R. 1226 (1994).

[15] In the Matter of Social Contract for Comcast Cable Communications, Inc., Order, FCC 97-375 (adopted October 9, 1997) at ¶ 6.

[16] Id.

[17] In the Matter of Social Contract for Time Warner, Memorandum Opinion and Order, FCC 95-478 (adopted November 30, 1995) at ¶ 11.

Cablevision[18] entered into a Social Contract in which it agreed to invest at least $1.7 billion to rebuild and upgrade all of its domestic cable systems between 1995 and 2000, and for which the Commission permitted Continental to increase its monthly rates for cable programming service in certain systems.[19]

In addition to Social Contracts, the Commission has crafted other mechanisms to allow cable operators to recover monies expended on system upgrades. The cable rate regulations contained in Part 76 provide for rate increases for operators who "undertake significant network upgrades requiring added capital investment" when it can be demonstrated that the investment will benefit subscribers.[20] Thus, the Commission has demonstrated a policy of modifying its rules to allow reasonable rate increases in regulated systems in order to promote system enhancements. This important Commission policy was correctly conceived and is in the public interest.

3. In the face of competition and the industry's overall move to advanced services and digital transmission, cable operators have begun the process of upgrading their networks to the benefit of subscribers. A freeze on cable rates could delay the digital rollout plans of various MSOs and independent operators across the country.

Two years ago, in its 1995 Report to Congress on the status of video competition, the Commission declared that many multichannel video programming distributors were planning to increase bandwidth and two-way network capabilities in anticipation of emerging competition.[21] Those plans are now being implemented across the nation. A

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[18] Continental Cablevision has since changed its name to MediaOne.

[19] In the Matter of Social Contract for Continental Cablevision, Order, FCC 96-358 (adopted August 21, 1996) at ¶¶ 26-36.

[20] 47 CFR § 76.922(j).

[21] In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, Second Annual Report, FCC 95-491 (adopted December 7, 1995) at ¶ 179.

rate freeze would not only curtail future network investment, but would deny cable operators who have already upgraded their systems and purchased equipment to recoup the costs of those investments. Many other cable operators have entered into contracts to purchase digital or advanced analog equipment; denial of justifiable rate increases at this point in time will be particularly damaging to these operators.

Cable companies are expected to invest about $2.7 billion in system upgrades this year, a 30% increase over last year.[22] By year's end, approximately 41% of U.S. cable homes could be served by systems with capacity of 750 MHz, compared to about 28% at the end of 1996.[23] In fact, a few systems have chosen to bypass a 750 MHz upgrade and move directly to an 860 MHz system, which may become the future standard for upgraded networks. Other operators have chosen to aggressively invest in digital video compression technologies and sophisticated headend equipment to expand the number and diversity of services offered over their systems.

To date, NextLevel has shipped 320 digital cable headends -- which will pass 16 million homes -- and 500,000 digital converters to cable operators who are now in the process of rolling out digital services to subscribers, or of conducting digital trials in preparation for future rollouts. TCI has announced extensive digital plans, seeking to have digital service available to two-thirds of its cable customers by the end of this year;[24] most of the other top MSOs have digital rollout plans in place and are beginning to step

[22] Regina Matthews, "Cable Sees Better Days on Wall Street," Cable World, Sept. 22, 1997, at 33.
[23] Id.
[24] Written testimony of Leo J. Hindery, Jr., President, Telecommunications Inc., before the United States Senate, Subcommittee on Antitrust, Business Rights and Competition, "Hearing on Antitrust and Competition Issues in the Cable and Video Markets," (October 8, 1997), at 4.

up their deployment activity.[25] NextLevel also has announced that 78 independent cable operators across the nation have signed Letters of Intent to purchase digital set-top converters. In addition to the digital rollouts, many other cable operators are upgrading their analog networks to offer additional channels and some advanced services.

Digital cable television can offer subscribers a myriad of technologies and service options, including interactive on-screen programming guides, parental control features, digital stereo music channels, pay-per-view channels, and the higher channel capacity gained through digital compression. Many cable systems are adding Internet services through the use of cable modems, a technology that delivers Internet content at up to 1,000 times the speed of traditional telephone modems. Future set-top converters will combine these functions to allow Internet access and program interactivity through the converter.

The Commission recognizes that the digital television revolution has begun. Yet the nation still has a long way to go before achieving the kind of interconnectivity envisioned in the 1996 Telecommunications Act. Infrastructure investment by system operators and continued research and development by vendors are essential. Government action that jeopardizes these investments inherently jeopardizes the speed at which our nation will achieve its interconnectivity goals.

[25] Price Colman, "Digital front heats up," Broadcasting & Cable, Oct. 13, 1997, at 44.

CONCLUSION

The Commission should deny Petitioners' call for a cable rate freeze, and continue its correct policy of permitting cable operators' recovery of network investment dollars. The Commission can best seek to protect consumers by continuing to open markets to competition, as sought by Congress in the Telecommunications Act of 1996, and by promoting investment in the nation's broadband infrastructure.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Faye R. Morrison, certify that a copy of the foregoing "Opposition of NextLevel Systems, Inc." was sent by U.S. Mail, on October 30, 1997, to the following:

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