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Before the
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 NATIONAL CABLE TELEVISION ASSOCIATION, INC.

Daniel L. Brenner
Michael S. Schooler
Loretta P. Polk

1724 Massachusetts Avenue, N.W.
Washington, D.C. 20036
202-775-3664

Counsel for National Cable Television Association

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The National Cable Television Association, Inc. ("NCTA") hereby opposes the above-captioned petition for rulemaking, filed by Consumers Union and the Consumer Federation of America ("Petitioners").

INTRODUCTION AND SUMMARY

Petitioners contend that cable television rate increases have been excessive and should be frozen while the Commission decides whether to change its rate regulation rules. But the petitioners fail to address, let alone answer, this central question: If, after cutting rates 17% to a "reasonable" and "competitive" level, the Commission's cable rate regulation rules strictly limit rate increases to costs plus specified amounts needed to stimulate desirable investment, and if that investment improves the attractiveness of program offerings to consumers, how can rate increases be *un*reasonable or reflect *anti*competitive practices?

As the Commission knows, its rules specifically limit rate increases to pass-throughs of (1) inflation; (2) certain "external" costs that increase faster than inflation (including programming costs, which the Commission *expected* to increase faster than inflation); and (3) a limited additional amount that the Commission has deemed necessary and sufficient to permit investment in programming and system upgrades.

It is hard to see, and the petitioners do not explain, how rate increases limited to these pass-throughs can be deemed excessive or "monopolistic." And there is no evidence, nor do the petitioners contend, that cable rate increases have exceeded what the rules permit.

Perhaps most significantly, the Commission already concluded that "subscribers have benefitted by receiving more product for less money."[1] And consumers themselves have responded -- as cable's viewing shares have steadily increased, reflecting quality improvements. Indeed, even the petitioners concede that the rate increases -- especially those allowed by the Commission's 1994 "going forward" rules -- have been accompanied by significant enhancements to the quantity and quality of cable service.[2] But what the petitioners fail to recognize is that price increases that produce more and better services are very different than price increases for a static, unchanged product. So they simply report that regulated cable price increases are higher than inflation (which measures the *average* price increase of *all* goods and services) -- which the Commission's rules explicitly allow and anticipate.

In sum, as cable rate have increased, the number of new networks has increased dramatically, investment in programming on existing channels has substantially increased, and investment in upgraded facilities has improved the range and quality of service offerings. Consumers have responded positively to those enhancements -- as subscribership went up and

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1 Cable Services Bureau, *Report on Impact of Going Forward Rules* (March 23, 1995).

2 *See* Statement of Dr. Mark N. Cooper, attached to petition ("Cooper Statement"), ¶ 52.

viewership and ratings of cable network programming jumped, clearly reflecting the *increased value* of cable service.

In these circumstances, there is no reason why the Commission should undertake yet another review of its rules -- much less impose a rate freeze. While the Commission's "going forward" rules appear to have had their intended effect of encouraging the addition of new programming without producing excessive rate increases, those rules expire in any event at the end of this year.

Moreover, competition in the video marketplace is rapidly emerging as an independent constraint on cable rates, wholly apart from the remaining rate regulation rules (which stay in effect until March 1999 for cable programming service ("CPS") tiers, and indefinitely, in most cases, for basic service). Cable's competitors now serve 13 percent of the households that subscribe to multichannel services. And although cable operators have managed to retain a large portion of their existing subscribers, this indicates an effective response to competition in the marketplace with desirable product enhancements rather than an immunity to such competition.

In addition to seeking a rate freeze, petitioners also ask the Commission to "reevaluate" its existing rules limiting horizontal and vertical ownership in the cable industry and to lift the current stay of the horizontal rules. There is no need for the Commission to initiate a proceeding to examine these rules because the Commission is already in the process of examining the state of competition in the video marketplace, as it is required by the 1992 Act to do each year. In each of its previous annual reports, the Commission has determined that there was no need for more stringent rules. As NCTA's comments in the current annual investigation showed, that is still the case.

I. THERE IS NO REASON TO BELIEVE THAT RATE INCREASES SUBJECT TO THE COMMISSION'S RULES HAVE BEEN UNREASONABLE.

The essence of petitioners' argument is that the Commission's rate regulation rules have "failed to restrain monopolistic pricing . . . by the cable industry."[3] According to Consumers Union's co-director, those rules are a "sham."[4] The basis for this contention is that average rates for regulated tiers of cable service have increased by more than the rate of inflation and (supposedly) by more than the Commission had predicted.[5]

Petitioners do not suggest that cable operators are increasing rates by more than the rules allow. To the contrary, they argue that because "the Commission's current regulatory formula permits monopolistic rate increases, there is no reason for a franchising authority to waste its resources and file complaints that would be rejected."[6] But petitioners nowhere explain what is supposedly *wrong* with the Commission's rules, which have been continuously revised and refined by the Commission in 14 reconsideration orders since their initial adoption four and a half years ago. Those rules strictly limit rate increases to no more than what is necessary to cover (1) inflation, (2) certain defined "external" costs, and (3) a limited additional amount that the Commission concluded was necessary to justify an operator's investment in more or improved programming or significant system upgrades.

Petitioners may disagree with the Commission's determination that such investments should be permitted and encouraged by the rules. But there is no basis for concluding that rate

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3 Petition at 3.

4 "Freeze Cable TV Rates, Consumer Groups Urge," *Washington Post*, Sept. 24, 1997.

5 Petition at 4.

6 *Id.* at 8 n.29.

increases limited under the rules to such amounts are "monopolistic" or that they are in any way inconsistent with the policy objectives underlying those rules.

A. <u>The Rules Permit Only "Reasonable" Rate Increases.</u>

In its initial rulemaking proceeding to implement the rate regulation provisions of the 1992 Cable Act, the Commission surveyed the rates of cable systems and determined that the rates of systems subject to effective competition were, on average, ten percent lower than the rates of non-competitive systems. Regulated systems were therefore generally required, at the outset, to reduce their rates by ten percent or to "benchmark" levels that were ten percent below the average rates charged by systems with similar characteristics. On reconsideration a year later, the Commission reexamined its rate survey and concluded that the difference between the rates of competitive and non-competitive systems was 17 percent. The benchmarks were revised, and systems were generally required to reduce their initial regulated rates by an additional seven percent.[7]

The rules permitted regulated systems, after reducing rates to their initial regulated levels, to increase those rates periodically. Specifically, the "price cap" rules allowed systems to increase rates once a year by the rate of inflation, and to implement quarterly increases to pass through increases in certain "external costs," to the extent that such increases exceeded inflation. These external costs were limited to state and local taxes applicable to the provision of cable

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[7] The rules permit operators to make utility-type "cost-of-service" showings to justify rates (and rate increases) that are higher than what the benchmarks permit. Obviously, rate increases that have been approved by the Commission or by franchising authorities after a cost-of-service showing cannot be deemed excessive or "monopolistic," since the point of such a showing is to demonstrate that rates are no higher than legitimate costs plus a reasonable return on investment.

service, franchise fees, certain costs of complying with franchise requirements, retransmission consent and copyright fees for the retransmission of broadcast signals, and programming costs.

The rate of inflation, as measured by the consumer price index (or any other generally used index) is, of course, a measure of the *average* price increase of all goods and services. While the rate of inflation is commonly used as the standard to which price increases of particular products are compared, the mere fact that a particular product's price increases by more than the average hardly constitutes evidence of monopolistic pricing. Even if the quality of the product remains unchanged, its price may change at a rate different from inflation for a variety of reasons, such as changes in the cost of its inputs. And if the quality of the product is enhanced (for example, by providing a larger product or by using better but more expensive materials) one might *expect* its price to increase by more than the average rate of inflation.

For precisely these reasons, the Commission expected the costs of cable programming to continue to increase by more than the rate of inflation. In allowing pass-throughs for increases in programming costs, the Commission noted that "the record shows that programming costs have increased at a rate far exceeding the rate of inflation,"[8] and that these increases are generally attributable to "an increase in the quality and diversity of cable programming."[9]

The Commission recognized the risk that cable operators could conceivably "incur excessive programming costs and then pass them on to subscribers."[10] But it concluded that the greater risk was that, if pass-throughs were not allowed, rate regulation would suppress "the

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8 Report and Order, 8 FCC Rcd 5631, 5787 (1993).

9 *Id.* n.598 (*quoting* House Committee on Energy and Commerce, H.R. Rep. No. 102-628, 102d Cong., 2d Sess. at 86).

10 *Id.* at 5787.

continued growth of programming."[11] The Commission noted that, in any event, cable operators had a countervailing incentive *not* to incur excessive programming costs even if such costs could be passed on to subscribers because the resulting rate increases "may cause them to lose subscribers."[12]

The Commission was not so sure, however, that this countervailing incentive would prevail in transactions between *vertically integrated* cable operators and programmers. Therefore, it initially capped pass-throughs of cost increases attributable to *affiliated* program services to "the lesser of the annual incremental percentage increase in such costs or the GNP-PI."[13] It subsequently amended this provision to allow pass-throughs of affiliated programming costs in excess of inflation, provided that "the price charged to the affiliated system reflects either prevailing company prices offered in the marketplace to third parties (where the affiliated program supplier has established such prices) or the fair market value of the programming."[14]

The Commission said it would "monitor the impact" of allowing pass-throughs of programming cost increases.[15] It has repeatedly revisited its "price cap" rules but has never found the hypothetical risks of allowing such pass-throughs to outweigh the tangible benefits.[16]

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11 *Id.* at 5788.

12 *Id.*

13 *Id.*

14 *First Order on Reconsideration*, 9 FCC Rcd 1164, 1228 (1993).

15 *Report and Order*, 8 FCC Rcd at 5788.

16 *See, e.g., Second Report and Order*, 9 FCC Rcd 4119, 4234-45 (1994); *Sixth Order on Reconsideration*, 10 FCC Rcd 1226, 1244-71 (1994).

To the contrary, the Commission has concluded on several occasions that permissible pass-throughs for programming costs should include an extra amount *in addition to* actual costs in order to provide adequate incentives to invest in more and better programming. *First*, the Commission decided in 1994 that a 7.5 percent mark-up on increased programming costs was appropriate to "help promote the growth and diversity of cable programming services."[17]

Second, later that year, the Commission concluded that this mark-up, which was primarily designed to encourage increased investment in existing programming, did not provide adequate incentives to add *new* channels of programming -- "especially new channels with low license fees."[18] Many new programming services vying for carriage on cable systems are willing to provide their service to cable operators at very low (or no) initial cost in order to gain exposure to viewers and establish their value. A 7.5 percent mark-up on a very small amount is a minuscule amount -- which, the record showed, would not be sufficient to compensate operators for the costs and risks associated with activating and using a channel for an untested service.

Therefore, the Commission adopted "going forward" rules that allowed operators to pass through their programming costs plus a *fixed* -- rather than a *percentage* -- mark-up of 20 cents. This amount "represents the Commission's best estimate of the average amount by which operators in a competitive environment would adjust rates for the addition of a new channel, exclusive of programming costs."[19] But the Commission limited the extent to which subscribers' rates could increase under the rules.

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17 *Second Report and Order*, *supra*, 9 FCC Rcd at 4242.

18 *Sixth Order on Reconsideration*, supra, 10 FCC Rcd at 1231.

19 10 FCC Rcd at 1231.

First, the rules apply only to CPS tiers. This effectively ensures that rates for *basic* service will *not* increase as the result of adding new satellite services.

Second, the 20-cent per new channel "going forward" mark-up ends this year. It will not be available after December 31, 1997.

Third, the rules strictly limited the number of channels to which the mark-up could be attached. For channels added during 1995 and 1996, the total mark-up could not exceed $1.20 (*i.e.*, six channels). Another 20-cent mark-up could be taken for a channel added in 1997.

Finally, the Commission also strictly limited the total licensing fees for programming on new channels that could be passed through by systems that opted for the new approach. During the first two years, such pass-throughs were limited to 30 cents per subscriber per month.[20] Increases in licensing fees incurred in 1997 could be passed through in their entirety.

Thus, the Commission struck a balance that it believed would "provide an adequate incentive to operators to add new services to CPSTs, while protecting subscriber interests by keeping overall regulated rates reasonable."[21] Whether an operator opted for the original approach of a 7.5 percent mark-up or the alternative of a flat 20 cent per-channel mark-up for programming, its rate increases were limited to no more than (1) inflation, plus (2) external costs actually incurred, plus (3) an additional mark-up on programming costs that was no greater than what the Commission deemed necessary to justify investment in more or better programming. It

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[20] In addition, if an operator added fewer than six new channels during 1995 and 1996 and thus used less than its allowable $1.20 mark-up, the unused portion could be used to recover licensing fees in excess of the 30-cent limit.

[21] 10 FCC Rcd at 1231.

is hard to see how increases pursuant to these defined price cap restraints could be viewed as "monopolistic," as petitioners contend.[22]

B. The Rules Are Working as Expected To Limit Rate Increases While Encouraging Investment in Programming and Facilities.

Petitioners contend that the "going forward" rules have resulted in larger rate increases than the Commission had predicted[23] -- and that, therefore, those increases must be unreasonable. Even if rate increases had, in fact, surpassed the Commission's expectations, this would hardly prove that they were monopolistic or unreasonable. Petitioners' contention suggests that the Commission decided in advance that a particular level of rate increases would be "reasonable," and then jerry-rigged its price cap rules to produce that level of increase. That, of course, is not the case.

What the Commission decided was that once initial rates were reduced to a reasonable level (based on rates charged by systems subject to effective competition), additional rate increases that were no greater than external costs (plus a limited additional mark-up that was necessary to justify investing in the provision of more and better programming) would be reasonable. If rate increases pursuant to such restrictions exceeded the Commission's

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[22] The Commission's rules also provide special procedures to permit operators to increase their rates when necessary to facilitate the upgrading of their facilities. Thus, operators are permitted to make truncated "cost-of-service" showings to justify rate increases that cover the costs of such upgrades. In addition, pursuant to its "upgrade incentive" approach, the Commission has entered into "social contracts" with several multiple system operators. These social contracts generally provide operators with somewhat greater flexibility in the pricing and packaging of services than would otherwise be permitted under the rules in return for a commitment to upgrade facilities and provide certain other services, such as the wiring of schools. In each case, the Commission has determined (as it is required by statute to do) that any rate increases permitted by the social contract would not be unreasonable.

[23] *See* Petition at 6, citing Cooper Statement, ¶ 12.

predictions, that would indicate that the predictions were wrong -- not that the increases were unreasonable.

1. Rate Increases Do Not Appear To Have Exceeded Expectations.

In any event, there is no evidence that the rate increases *did* exceed the Commission's predictions. Indeed, it is not even clear at the outset where or whether the Commission made any such predictions. To support their assertion, petitioners provide a graph (Figure 2, attached to the Statement of Dr. Cooper) that purports to show "predicted and actual rates under the going forward rule." But they provide no citation or source for the "predicted" rates that appear in their graph.

Even taking petitioners' graph at face value, however, the graph does not support their assertion that actual rate increases have exceeded the Commission's expectations. The lines on that graph representing actual and predicted rates intersect repeatedly. For some portions of each year, actual rates exceed predicted rates; during other portions, the opposite is true. Thus, the graph shows that actual rates exceeded predicted rates in July 1997 -- the most recent date on the graph. It also appears to show that actual rates exceeded predicted rates in July 1996, and, by a very small amount, in July 1995. But the graph also indicates that actual rates were *lower* than predicted rates in January 1997, January 1996, and January 1995. In fact, it appears from petitioners' graph that actual rates were lower than predicted rates as often as they exceeded them.

It is not hard to interpret these intersecting lines. For a period of time shortly after a large number of cable operators implement the annual rate increases permitted by the rules, actual rates apparently leap ahead of "predictions." Then, as rates remain stable, predicted rates overcome actual rates until the cycle repeats itself again. What Figure 2 suggests, if anything, is that periodic increases in cable rates should not be cause for alarm -- because, on average, actual rate increases under the "going forward" rules are in line with what petitioners say the Commission expected.

2. The "Going Forward" Rules Have Been Accompanied by Increases in the Quantity and Quality of Cable Service.

Certainly, the "going forward" rules have met the Commission's expectations with respect to their effect on the quantity and quality of cable programming. As the Commission noted in 1995,

> [t]he programming industry seems to be gaining confidence in its ability to gain carriage due to the *Going Forward* rules. This is reflected in a large increase in the number of national cable networks being launched....
>
> The *Going Forward* rules have meant that subscribers have benefitted by receiving more product for less money.... In short, under *Going Forward* consumers are getting between two and three times more for their money for new services on regulated tiers.[24]

What the Commission recognized -- and what petitioners ignore -- is that price increases that are related to more and better service are very different from price increases for a static and unchanged product. Thus, petitioners attempt to show that basic and CPS rate increases are monopolistic and unreasonable by noting that "[w]hile the price of basic and expanded basic cable programming shot up 19% in 1995, the price of competitive premium cable channels and non-cable-owned broadcast channels rose only 2%."[25] As the Commission itself pointed out, however, the 19% increase in the amount paid by cable operators for non-premium cable network programming includes not only increases in licensing fees charged by existing

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24 Cable Services Bureau, *Report on Impact of Going Forward Rules* (March 23, 1995).

25 Petition at 17.

programmers but also increases in the *number of channels* of non-premium programming carried by systems[26] and increases in the *number of subscribers*.[27]

Moreover, not only the quantity but also the *quality* of cable programming has increased while the "going forward" rules have been in effect. One objective measure of perceived quality is viewership ratings, and ratings for cable programming continue to rise. For example, during the first month of this fall's new television season, advertiser-supported cable networks gained more than two million households, while the four major broadcast networks lost more than 1.2 million homes.[28]

Measured on a *per-channel* basis, the price of basic and CPS tiers have remained relatively constant since 1991, at approximately 50 cents,[29] even though the *quality* of programming on many basic and CPS channels has also steadily increased during that period. It is meaningless to compare the increased amount paid by operators for tiers that include this expanded array of programming to the increased amount paid for an individual premium channel.

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26 Thus, in 1995, many systems added the maximum six new channels for which they could recover the 20-cent mark-up under the "going forward" rules. By early 1995, the Commission had determined that, as the result of the rules, at least 12 existing networks and two new networks had each gained more than a million subscribers. *Report on Impact of Going Forward Rules, supra* at 2.

27 *Third Annual Report*, 12 FCC Rcd 4358, 4370 n.41 (1997). Licensing fees are generally paid on a per-subscriber basis. Therefore, an increase in the number of subscribers to a tier will increase the aggregate fees paid for all programming on the tier without any increase in per-subscriber fees.

28 "Cable Viewing Up in New Season," *Cable World*, Oct. 27, 1997, p.3 (citing data from the Cabletelevision Advertising Bureau). Indeed, during the three previous television seasons, cable programming's viewership share has increased from 34.2 to 39.0. *See* Cabletelevision Advertising Bureau, *1997 Cable TV Facts*, at 21.

29 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 per channel in April 1991. According to data from Paul Kagan Associates ("PKA"), the average price per channel in December 1996 was approximately 50 cents. *See* PKA, *The Cable TV Financial Databook*, June 1997, p. 9; PKA, *Cable TV Programming*, Aug. 31, 1997, p.1.

The petitioners, in the end, never really contest the Commission's determination that it is reasonable and necessary to allow operators to pass through their increased programming costs plus the limited mark-up permitted under the price cap and "going forward" rules. Nor do they dispute that cable operators have continuously provided more and better programming. As they concede, "[t]he benefits of increasing size and quality -- cable's historical pattern -- were still evident" following implementation of the 1992 Act.[30] But they insist that such improvements have been "accompanied by monopoly rents."[31] Their rhetoric includes no logical explanation for this conundrum: If rate increases cannot exceed costs plus an amount necessary to justify investment, and if the increased investment is enhancing the attractiveness of program offerings to consumers, how do such rate increases produce monopoly rents?

C. **There Is No Evidence that Operators Are Evading the Rules -- or that the Rules Need To Be Changed To Prevent Evasions.**

Petitioners identify two ways in which, they believe, cable operators are *evading* the rate regulation constraints, although they provide no evidence whatsoever that this is occurring. First, they suggest that even if operators are recovering no more than their programming costs plus a reasonable, risk-adjusted mark-up, "the price of cable-owned programming . . . has been artificially inflated to circumvent the goals of regulation."[32] But the Commission anticipated and dealt with this potential problem. As discussed above, the rules currently permit operators to pass through costs for programming purchased from affiliated companies, but only if they are charged either the same "prevailing company prices" that unaffiliated third parties pay or the fair

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30 Cooper Statement, ¶ 52.

31 *Id.*

32 Petition at 17.

market value of the programming.[33] Thus, if there were evidence that vertically integrated programmers were charging their affiliated operators any more than the marketplace price for unaffiliated operators -- and that the affiliated operators were including such higher charges in their external cost pass-throughs to customers -- the excess charges would have to be refunded.[34]

Second, petitioners argue that cable operators have "bundled services to justify excessive rate increases."[35] They assert that "[a]lthough consumers would be less willing to pay for certain elements of the larger cable programming package, they swallow the whole thing, since their access to those elements they really want is tied to those they do not want."[36] But the bundling of services into tiers has been the normal way of providing multichannel service to subscribers since long before the Commission's "going forward" rules and has nothing to do with justifying excessive rate increases. It has always been the case that different subscribers attach different values to each of the services offered on a tier -- just as different subscribers to a newspaper prefer different sections. Bundling low-priced services into tiers is, however, often the most economical and efficient way to provide an assortment of services that appeals to a maximum number of subscribers.

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33 47 C.F.R. § 76.922(f)(6).

34 After adopting this rule, the Commission considered amending it to allow the use of "prevailing prices" only where at least 75 percent of the programmer's sales are to non-affiliates. The Commission decided that this proposal was unnecessary "because there is no evidence in the record to suggest that a cable operator would have an incentive to pay excessive amounts for assets or services obtained from affiliates where an asset or service is widely distributed among cable operators." *Sixth Order on Reconsideration, supra,* 10 FCC Rcd at 1270.

35 Cooper Statement, ¶ 57.

36 *Id.*, ¶ 58.

From a technological standpoint, marketing channels on an à la carte basis (and blocking access to unpurchased channels) imposes substantial costs on cable operators and is simply not feasible in most systems today. The cost of providing an entire tier of services may be much less than the cost of providing a subset of such services to subscribers on an à la carte basis. Moreover, the survival of many programming services -- especially new services and services that depend in significant part on advertising revenues -- requires *potential* access to a maximum number of viewers, including those who might not choose to purchase such services before having an opportunity to view them. Offering a tier that combines established programming of broad appeal with new or "niche" programming services maximizes the quantity and diversity of programming available to customers. For these reasons, cable's new competitors, such as DBS and MMDS services also bundle most services into large tiers.[37]

When the Commission was considering the adoption of its "going forward" rules, some parties suggested that allowing operators to increase rates by a fixed, 20-cent mark-up for newly added channels would create incentives to recover excess profits by adding worthless, low-cost channels. That clearly has *not* happened because of the abundant supply of quality program networks -- supply that far exceeded not only the seven slots made available by the "going forward" rules but also the available channel capacity of most systems. Cable operators have used the "going forward" rules to add both new and established services that have substantially increased the quality and diversity of their service offerings. And cable's unregulated

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37 For example, EchoStar's most popular basic programming packages ("America's Top 40" and "America's Top 50") contain 40 to 50 channels of the most popular cable networks. Similarly, DirectTV's most popular package, "Total Choice," includes 44 channels.

competitors, such as DBS services, have chosen to add many of the same services to their packages.[38]

Petitioners suggest that the retiering of services formerly offered on a premium, per-channel basis (such as Disney Channel and several regional sports networks) is a form of "abusive pricing" that is meant to "camouflage rate increases."[39] For a large number of subscribers, however, the retiering of such services results in a beneficial rate *reduction*, because the increased cost of the tier is much less than the former à la carte price of the service. All those subscribers who had been purchasing the Disney Channel or the regional sports networks as premium services are, as the result of retiering, able to purchase the same services as before at a substantially lower price. Retiering also benefits all those subscribers who chose not to purchase the services at their premium per-channel prices but who would have purchased them at the lower incremental cost at which they are now available. Only those subscribers who would not choose to purchase the services at that lower cost are made worse off by the retiering.

What makes petitioners believe that the adverse effects of retiering on the latter group of consumers outweighs the beneficial effects on the others? They provide absolutely no evidence that this is the case.

There *is*, however, evidence that the retiering of premium services has generally been a *pro*-competitive response to marketplace demand and has enhanced consumer welfare. Some DBS services generally chose from the outset to offer the Disney Channel and regional sports

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38 The Disney Channel is included in EchoStar's "Top 40" and "Top 50" packages, and the "Top 50" package also includes a regional sports network. DirectTV's "Total Choice" package similarly includes The Disney Channel and one regional sports network.

39 Cooper Statement, ¶ 57.

services as tiered services. Their intention certainly was not to evade rate regulation or to "camouflage rate increases." They must have concluded that subscribers would prefer this marketing approach -- and many cable operators, in seeking to retain or add subscribers, obviously reached the same conclusion.

D. **Increased Rates and Increased Investment Are a Pro-Competitive Response to an Increasingly Competitive Video Marketplace.**

The video marketplace is rapidly becoming a competitive marketplace -- although petitioners refuse to acknowledge that this is the case. 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."[40] By May 1997, that number had declined to 87%, and 9.5 million households were obtaining multichannel video services from sources other than an incumbent cable operator. Nevertheless, petitioners attempt to portray recent increases in (regulated) cable rates as simply the product of "the enduring monopoly structure of the cable industry," arguing that "[t]here is nothing in the industry to suggest it will change its stripes."[41]

One reason why the structure of the industry, as portrayed by petitioners, seems never to change despite the growth of DBS and other competitive multichannel services is that petitioners continue to rely on data that predate the advent of DBS. For example, petitioners contend that

> [o]n the demand side, a low to moderate price elasticity and a positive income elasticity are crucial characteristics of the industry. They convey market power and an ideal opportunity for the cable industry to exploit consumers.[42]

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40 Annual Assessment of Competition in the Market for the Delivery of Video Programming, FCC 96-496, rel. Jan. 2, 1997, at 5.

41 *Id.*, ¶ 18.

42 *Id.*, ¶ 19.

But the *most recent* article they cite to demonstrate "low to moderate" elasticity of demand and a "moderate, positive income elasticity" is *six years old* -- and all the other "econometric analyses" upon which they rely appeared between 1971 and 1985. Most of this data was stale when petitioners first cited it during the legislative debate over the 1992 Act. It is utterly useless in assessing the effect of DBS and other multichannel services on demand and income elasticity at the end of 1997.

In attempting to show that "[t]he recent expansion of other multi-channel providers has had little if any impact on cable growth," petitioners assert, without citation, that "[i]n the three years from 1994 to 1996, when other multichannel systems added six million subscribers . . . . [cable] added over 11 million subscribers."[43] In this case, petitioners' data (wherever it comes from) may not be stale, but it is *wrong*. Between November 1993 and November 1996, cable added 5.8 million subscribers[44] -- *i.e.*, half as many as claimed by petitioners, and approximately the same number as were added by cable's competitors. The comparable growth of cable and its competitors in recent years belies petitioners' efforts to show that DBS and other multichannel providers cannot compete effectively with cable and that "another decade of severe price increases would be sustainable before DBS is to be the disciplinary force in the marketplace."[45]

The fact that cable's market share, as measured by revenues or subscribership, remains high (and that the Herfindahl-Hirschman Index for the local multichannel video programming

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43 *Id.*, ¶ 36.

44 A. C. Nielsen, *Cable Universe Estimates*, Nov. 1993 and Nov. 1996.

45 Cooper Statement, ¶ 29.

distribution marketplace, when based on such measures of market shares, is also high) does not show, as petitioners contend, that cable operators retain significant market power. As Dr. Steven S. Wildman, an expert on the economics of the video marketplace, has explained:

> Having started with close to one hundred percent of MVPD subscribers, cable systems can be expected to retain the bulk of the subscribers they had prior to competition for a considerable period of time, even if competition is intense, as long as they respond to entry with attractive services and competitive prices. In this situation HHIs calculated from either shares of subscribers or shares of revenue will inevitably, and inappropriately, give the appearance of substantial market power for cable operators, regardless of how competitive the market actually is. In fact, with subscriber or revenue share-based HHIs, a market in which the incumbent rapidly loses share because it does not offer an attractive alternative to entrants' services will appear to be more competitive than a market in which the incumbent retains most of its customers by improving its service and lowering its price.[46]

In short, since cable's share of subscribership and revenues is not rapidly eroding while cable and its new competitors appear to be attracting roughly equal numbers of *new* subscribers to multichannel service, it is most reasonable to conclude that those new services are perceived as good alternatives to cable *and* that cable operators are responding to those services with competitive offerings.

That operators are responding to competition by increasing the quantity and quality of service rather than simply by reducing prices should not be surprising. Nor should it be cause for concern. When a new competitor enters the marketplace, the best competitive response -- and the response that best meets consumer demand -- is often to provide an improved product. Existing competitors may seek to provide a product that more closely resembles the new entrant's, or they may seek to differentiate their product from the new entrant's with additional

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46 S. Wildman, *Cable Participation in LMDS*, attachment to Reply Comments of Comcast Corporation in CC Docket No. 92-297, Aug. 22, 1996, p. 6.

features that appeal to consumers. In either case, such a competitive response can "cause consumers to be better off, even though the prices of incumbents' products or services increase."[47]

In our comments in response to the Commission's Notice of Inquiry in connection with its annual report on competition in the video marketplace, we showed that providing a higher-cost, higher-price product was a typical (and pro-competitive) response to new competition, both by manufacturers (*e.g.*, automobiles) and by retailers (*e.g.*, supermarkets and department stores).[48]

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In sum, there is no reason to believe that recent increases in regulated cable rates are anything other than what the Commission hoped to encourage with its rules -- *i.e.*, a reflection of increased investment in the quantity and quality of cable service in order to respond to consumer demand. Moreover, this increased investment in facilities and program offerings appears to be a response to the increasingly competitive marketplace that Congress anticipated when it imposed a 1999 sunset on the regulation of CPS rates. To freeze rates in these circumstances, as petitioners request, would simply freeze investment in programming, facilities and technology. This may be what petitioners would prefer, but it is demonstrably not what the marketplace prefers.

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47 Economists Incorporated, *An Assessment of Multichannel Video Competition* 17 (1997) (attached to NCTA Comments in CS Docket No. 97-141).

48 *See id.* at 18-23.

II. FREEZING RATES WOULD BE CONTRARY TO LAW -- AND TO THE PUBLIC INTEREST.

Petitioners suggest that just as the Commission had authority under Section 623 of the Act to freeze cable rates in April 1993 "while it finalized its cable rate regulations," it now has authority to "freeze cable rates while it investigates its rate regulation formula."[49] There is, of course, a critical difference between then and now. The Commission froze rates in 1993 after it had completed its rulemaking proceeding to implement the rate regulation provisions of the 1992 Act. In that proceeding, the Commission determined that the rates of cable systems not subject to effective competition should be reduced by approximately 10 percent, and it adopted rules and standards for effectuating such a reduction in basic and CPS rates. But the Commission recognized that the new rules could not be implemented overnight. It was

> concerned that during the period between the adoption of our rules and the date that a local franchising authority can establish regulation of the basic service tier and that consumers can file complaints with the Commission concerning potentially unreasonable rates for cable programming services, cable operators could raise rates, effectively undermining the statutory purpose of reasonable rates pending implementation of our rules.[50]

The Commission has made no similar determination that current rates are unreasonable. To the contrary, current rates have been established pursuant to the Commission's regulations, which have been crafted and continuously refined to ensure that rates (and rate increases) are *not* unreasonable. Even if petitioners' mere assertion that rate increases under the current rules have been unreasonable provided a sufficient basis for launching the open-ended "reevaluation of its

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49 Petition at 5.

50 *Order*, 8 FCC Rcd 2921 (1993).

cable rate regulations"[51] that petitioners seek (which it does not), it would provide no basis for freezing rates at the *outset* of its investigation.

The Commission has no basis for *presuming* that its rules are somehow defective and that future rate increases consistent with its current rules would be excessive. In seeking further reconsideration of the rules, petitioners have not identified any specific defects in the rules or proposed any specific amendments. Thus, even assuming that the Commission had jurisdiction to freeze rates in 1993 on the ground that a temporary freeze pending implementation of its new rules was necessary to fulfill its obligation under Section 623, it has no comparable authority to impose the freeze that petitioners now seek.

Furthermore, a freeze on rates would not only exceed the Commission's *statutory* authority but would raise serious *constitutional* problems as well. If rate regulation (much less a rate *freeze*) had the effect of capping expenditures on programming, it would run afoul of the First Amendment. The United States Court of Appeals for the District of Columbia Circuit, in upholding the constitutionality of the rate regulation rules, specifically relied on the FCC's rules permitting operators to pass through programming cost increases plus a reasonable mark-up.[52] It is one thing for petitioners to decide that rates and programming expenditures should be frozen at their current level. But it would be something else -- specifically, it would be unconstitutional -- for the Commission to make that decision and implement it by freezing rates or eliminating programming cost pass-throughs.

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51 Petition at 6.

52 *See Time Warner Entertainment Co. L.P. v. FCC*, 56 F.3d 151, 183 (D.C. Cir. 1995).