

BEFORE THE DOCKET FILE COPY ORIGINAL  
**Federal Communications Commission**

WASHINGTON, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

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 )

**REPLY OF TIME WARNER CABLE**

Time Warner Cable ("Time Warner"), by its attorneys, hereby submits the following Reply with respect to the above-captioned petition for rulemaking filed by the Consumers Union and Consumers Federation of America ("Petitioners"). The purpose of this Reply is to add Time Warner to the roster of commenters opposing Petitioners' demand for the imposition of a freeze on cable prices and for an expansion of government regulation of the video marketplace through the adoption of additional horizontal and vertical ownership restrictions. As the comments in this proceeding demonstrate, the imposition of a draconian rate freeze on an industry whose prices are already extensively regulated cannot be justified either factually or legally and, in the case of those cable operators (including Time Warner) who are parties to "Social Contracts" with the Commission, would breach agreements entered into and relied upon in good faith. The comments also establish that there is no need for the Commission to initiate a proceeding to "reevaluate" (*i.e.*, expand) its existing rules pertaining to horizontal and vertical ownership in the cable industry, particularly in light of the constitutionally suspect character of those rules.

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I. THE PETITIONERS HAVE FAILED TO PUT FORWARD A CREDIBLE FACTUAL OR LEGAL ARGUMENT IN SUPPORT OF THEIR DEMAND FOR THE IMPOSITION OF A RATE FREEZE

As the Commission is well aware, cable television rates are subject to extensive regulatory oversight, both at the state and local level (in the case of basic service tier rates) and at the federal level (in the case of optional cable service tier rates). Moreover, the Commission's rules not only restrict the magnitude of cable rate increases, but also address such matters as the timing and frequency of those increases, the minimum content of the basic service tier, the use of buy-through marketing, and even the offering of discounted rates within a franchise area. Under the circumstances, a heavy burden of proof falls on Petitioners when they declare this extensive regulatory regime a "sham" and call for the immediate imposition of a freeze on cable rates.<sup>1</sup> Yet, as the comments submitted in the initial round of this proceeding thoroughly and thoughtfully demonstrate, Petitioners have not come close to establishing a credible factual or legal foundation for their position.

For example, Petitioners assert that cable rates are increasing faster than inflation, thereby proving that the existing regulatory structure is not constraining "monopolistic pricing" on the part of cable operators. Petition at 3-4. In fact, as NCTA (among others) has pointed out, "the mere fact that a particular product's price increases by more than [the rate of inflation] hardly constitutes evidence of monopolistic pricing." NCTA Opp. at 6. Petitioners' reliance on inflation as a comparative standard ignores the fact that cable service is not a static product and that increases in costs that enhance and improve the quality (and

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<sup>1</sup>"Freeze Cable TV Rates, Consumer Groups Urge," *Washington Post*, Sept. 24, 1997.

quantity) of a product or service advance consumer welfare, even when accompanied by price increases that exceed inflation.

The statistical evidence submitted by commenters opposing the rate freeze (which Time Warner will not herein repeat) conclusively establishes that cable price increases have been accompanied by increases in the quantity and quality of service offered and that such increased investment represents a pro-competitive and pro-consumer response. Given the dynamic nature of the product involved, Congress has recognized that the appropriate standard by which cable rates should be measured is not inflation or some other arbitrary reference point. Rather, it is whether the rate increases are "reasonable." The Commission has defined "reasonableness" in the case of cable rates by setting initial rates at a competitive "benchmark" level and by restricting increases to external costs plus a limited mark-up designed to promote investment in new programming and facilities. Petitioners have not -- and cannot -- offer any evidence that rates established consistent with these regulatory constraints are "unreasonable."

The flaws inherent in Petitioners' simplistic economic and factual analyses are compounded by the deficiencies in their legal argument. Petitioners cite the precedent set by the rate freeze imposed by the Commission when it first implemented the rate regulation provisions of the 1992 Cable Act as a basis for the imposition of a new freeze. Petition at 9. This argument ignores the fact that the earlier freeze was specifically designed to address the transition from an industry without rate regulation to an industry that is pervasively regulated. In contrast, the freeze now sought by Petitioners would apply to prices that already have been rolled back to "competitive" levels, have continued to be subject to

pervasive regulation, and have not been shown to be violative of the applicable regulatory standard. Additionally, imposing a new freeze on regulated cable rates not only would exceed the Commission's statutory authority (which is to ensure that rates are reasonable), but also raises substantial constitutional questions. As NCTA has pointed out, the decision of the United States Court of Appeals upholding the constitutionality of the Commission's rate rules specifically cited the fact that those rules allowed operators to pass through programming costs plus a reasonable mark-up.<sup>2</sup> A rate freeze that served to cap expenditures on programming or even to prevent a cable operator from recovering legitimate cost increases would not meet constitutional muster under the Court's analysis. Nor would it represent an appropriate regulatory response as to purported problem -- that cable rates have spiraled out of control with regulation -- has not been shown to exist and, in any event, would not be a narrowly tailored response.<sup>3</sup>

Finally, Time Warner has a special interest in Petitioners' rate freeze proposal arising from the fact that Time Warner, like a number of other cable operators (including Comcast and MediaOne) has entered into a "Social Contract" with the Commission. In Time Warner's case, the Social Contract requires the company, *inter alia*, to invest \$4 billion from 1995 to 2000 to rebuild and upgrade its cable systems and to offer a free cable connection to all public schools passed by its systems and to wire additional public school classrooms and certain private schools at cost. In order to fund this investment, the Social Contract

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<sup>2</sup>NCTA Opp. at 23, *citing Time Warner Entertainment Co. L.P. v. FCC*, 56 F.3d 151, 183 (D.C. Cir. 1995).

<sup>3</sup>*See generally Turner Broadcasting System Inc. v. FCC*, 512 U.S. 622 (1994).

guarantees Time Warner an annual \$1.00 increase in its CPST rates over the period from 1995 through 2000.

Imposing a freeze on cable prices would breach Social Contracts such as that entered into between Time Warner and the Commission. By the end of 1997, Time Warner already will have expended \$3.4 billion cost (of the \$4 billion committed) in fulfillment of its obligations under the Social Contract and in reliance on the rate increases (including those not yet taken) provided for therein. Freezing rates would prevent or, at the very least, delay Time Warner's recovery of this investment and would make it impossible for the company to continue to meet its upgrade obligations. Such result would harm not only Time Warner, but also its subscribers (who, after all, are intended to be the ultimate beneficiaries of the Social Contract).

\* \* \* \*

In sum, Petitioners have clearly failed to establish the requisite factual or legal predicates for the imposition of a freeze on regulated cable rates. In arguing for such action, Petitioners have combined dubious economic theory with dubious legal analysis. Most importantly, they have erroneously assumed that increasing cable rates are anathema to the public interest. The comments in this proceeding, as well as five years of rate regulation experience, conclusively demonstrate that consumers benefit from improvements in cable services and facilities, even where the investments needed to make those improvements are reflected in increased prices.

II. PETITIONERS HAVE FAILED TO ESTABLISH THAT THERE IS ANY NEED FOR ADDITIONAL RESTRICTIONS ON HORIZONTAL OR VERTICAL OWNERSHIP

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Petitioners' primary focus (and their principal bid for headlines) clearly is their demand for a rate freeze. Almost as an afterthought, Petitioners also ask that the Commission lift its stay on enforcement of its horizontal ownership limits and otherwise consider measures expanding government regulation of horizontal and vertical ownership in the cable industry. Petition at 14-17. Such actions have been strongly opposed by a number of commenters. For the reasons given below, Time Warner agrees with these commenters that the Commission should reject the Petitioners' call for additional restrictions on horizontal and vertical ownership.

First, as both Congress and the Commission have recognized on several occasions, horizontal concentration and vertical integration are not intrinsically anti-consumer.<sup>4</sup> For example, many cable operators (including Time Warner) are seeking to create economies of scale and position themselves for entry into new lines of business (such as Internet services) by creating, through consolidation, regional "clusters." While Petitioners see such "clustering" as a source of concern, more objective observers, such as the Administration, have expressed support for this development, acknowledging that it can reduce costs and facilitate competition.<sup>5</sup>

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<sup>4</sup>See, e.g., H.R. Rep. No. 862, 102d Cong., 2d Sess. 41 (1992); S. Rep. No. 92, 102d Cong., 1st Sess. 33 (1997); *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, First Report, CS Docket No. 94-48, 9 FCC Rcd 7442 (1994).

<sup>5</sup>NCTA Comments at 28, citing Letter from Larry Irving, Ass't Secretary for  
(continued...)

Second, there is no need for a new proceeding regarding horizontal and vertical integration issues. The Commission already has in place a process by which it reviews and reports to Congress annually on the state of competition in the video marketplace. In addition, there is no evidence that current legal protections are inadequate. For example, the Federal Trade Commission and the Justice Department can and do review significant cable industry transactions (such as the Time Warner-Turner merger) and impose such conditions as are necessary to promote competition. Similarly, the Commission can and does address, on a case-by-case basis, complaints brought under the program access rules.<sup>6</sup>

Finally, the existing horizontal and vertical ownership rules are not constitutional. Indeed, the reason that the horizontal ownership rules have been stayed is that the United States District Court for the District of Columbia held those rules to be violative of the First Amendment. *Daniels Cablevision v. United States*, 835 F. Supp 1 (D.D.C. 1993). Appellate review of the constitutionality of those rules, along with the constitutionality of the vertical ownership limits, remains pending. As NCTA has pointed out, it would be imprudent under these circumstances for the Commission either to enforce the existing horizontal rules or to expand the vertical ownership rules.

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<sup>5</sup>(...continued)

Communications and Information, U.S. Dept. of Commerce to Chairman Janet D. Steiger, Federal Trade Commission, Jan. 12, 1995.

<sup>6</sup>Time Warner notes that Ameritech has filed comments in this proceeding in which it reiterates its request, made in a petition filed earlier this year, for changes in the program access rules. Time Warner hereby incorporates by reference its opposition to the Ameritech petition.

CONCLUSION

The record in this proceeding could not be more clear. Petitioners' request for the imposition of a freeze on cable rates and for expanded regulation of horizontal and vertical ownership in the cable industry is utterly without merit and represents nothing more than a shameless and pandering attempt to garner headlines. Consequently, Time Warner urges the Commission to act without delay in denying the instant petition. As the Commission hopefully learned from its ill-considered proposal in 1994 to adopt a "productivity offset," subjecting the cable industry to a lingering cloud of regulatory uncertainty not only is unfair, but also can impede long-term strategic planning and deter investment. Immediate action disposing of Petitioners' proposals will allow the Commission, the cable industry, and cable's growing competition to move forward in creating the marketplace that is responsive to consumer needs and interests.

Respectfully submitted,

**TIME WARNER CABLE**

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November 14, 1997

**CERTIFICATE OF SERVICE**

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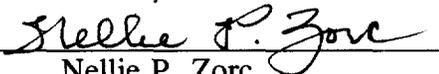
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