BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
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In the Matter of	)	
	)	
Implementation of Section 11(c)	)	
of the Cable Television Consumer	)	MM Docket No. 92-264
Protection and Competition	)	
Act of 1992	)	
	)	
Horizontal Ownership Limits	)	

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REPLY COMMENTS OF TELE-COMMUNICATIONS, INC.

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Stanley M. Besen and John R. Woodbury, Charles River Associates, "Comments on Dertouzos and Wildman, 'Programming Access and Effective Competition in Cable Television,'" September 3, 1998

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REPLY COMMENTS OF TELE-COMMUNICATIONS, INC.

Tele-Communications, Inc. ("TCI"), by its attorneys, hereby files its reply comments on the Further Notice of Proposed Rulemaking in the above-captioned proceeding.[1]

I. INTRODUCTION AND SUMMARY

In their comments, TCI and other cable entities demonstrated that the Commission should increase the current horizontal limit because, among other things: (1) new empirical evidence demonstrates that MSOs are not exercising monopsony power or engaging in vertical foreclosure; (2) significant changes in the MVPD marketplace since the current rules were adopted -- principally, the emergence and growth of DBS and other non-cable

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[1] Implementation of Section 11(c) of the Cable Television Consumer Protection and Competition Act of 1992: Horizontal Ownership Limits, MM Docket No. 92-264, Memorandum Opinion and Order on Reconsideration and Further Notice of Proposed Rulemaking, FCC 98-138 (rel. June 26, 1998) ("Second Order on Recon." and "Further NPRM," respectively).

MVPDs -- make it highly unlikely that monopsony or vertical foreclosure abuses will occur in the future; and (3) there are substantial benefits and efficiencies associated with larger MSOs, including program innovation and program cost reduction, as well as the expanded provision of competitive telephony and interactive broadband services, that may be sacrificed if the current limit is not raised.

By contrast, parties opposing a higher limit rely on purely theoretical concerns and "big is bad" rhetoric. These parties completely ignore the efficiencies and benefits of larger MSO size and fail to give any weight to changes in the MVPD marketplace -- changes that are directly relevant to the purposes underlying the horizontal limit -- that have occurred since the limit was adopted in 1993.

In short, the comments crystallize the central question faced by the Commission in this proceeding: Should the Commission find that the new evidence and the changes in the MVPD marketplace since 1993 mean that it can relax the horizontal rules, thereby facilitating the ability of companies like TCI to continue their efforts to innovate in the programming and technology areas and to deliver local telephone and interactive broadband competition to American consumers on a broad scale? Or should the Commission rely solely on the theoretical possibility of monopsony power and vertical foreclosure to refuse to increase the current limit and thereby threaten such pro-consumer developments?

TCI believes that the Commission's choice is obvious. The Commission should increase the limit to 40% and adopt an MVPD

subscriber-based formula. TCI responds below to each of the comments opposing this proposal.

II. THE RECORD SUPPORTS RAISING THE HORIZONTAL LIMIT TO 40%.

A. Commenters Presented Compelling Reasons And New Evidence Justifying A 40% Limit.

In its comments, TCI justified its proposal for a 40% limit based on the following:

- **New Evidence**. There is evidence that cable operators are not exercising monopsony power and, in particular, there is new empirical evidence -- that was not available to the Commission in 1993 -- which demonstrates that MSOs are not engaging in vertical foreclosure;

- **Changes in the MVPD Marketplace**. Changes in the MVPD marketplace since the current rule was adopted make it much less likely -- in fact, as Besen and Woodbury conclude, "quite remote"[2] -- that such anticompetitive behavior will occur in the future. The principal changes are the following: (a) increased MVPD competition; (b) the success and strengthening of other existing cable restrictions aimed at addressing the very same behavior targeted by the horizontal limit; and (c) the expansion in channel capacity made possible by digital video technology, which provides additional outlets for program services and thereby reduces an MSO's ability to limit program diversity;

- **Significant Efficiencies**. There are substantial efficiencies and benefits associated with larger MSOs, including program cost reduction and program innovation;

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[2] See Dr. Stanley M. Besen and Dr. John R. Woodbury, Charles River Associates Incorporated, "An Economic Analysis of the FCC's Cable Ownership Restrictions," August 14, 1998, at 13 ("Besen and Woodbury"), filed as an attachment to TCI's comments.

- **Provision of Competitive Telephony and Interactive Broadband Services**. A higher horizontal limit is particularly warranted to enable cable operators to obtain a network size sufficient to support and further promote the extraordinary investment in new technology and system upgrades required to provide competitive telephony and interactive broadband services to more American consumers;

- **The Higher Antitrust Standard**. The antitrust standard is 50%, which TCI believes would also be justified here in light of the absence of any evidence that the concerns underlying the horizontal limit have materialized or are likely to materialize in the new, more highly competitive MVPD marketplace;

- **The Broadcast Limit is Effectively Above 40%**. Several broadcasters already are near or over 40% without the benefit of the UHF discount. Indeed, Paxson Communications is at 61.4% and Fox is at 40.5% before discounting UHF station reach by a factor of 50%. Moreover, the Commission has proposed to increase the broadcast limit to 50%, and several broadcasters have supported elimination of the limit in its entirety; and

- **Programmers Achieve Viability Well Below 60% Penetration**. Many program services have flourished at subscriber penetration levels well below 60%. Consequently, a programmer that fails to sell its product to an MSO having 40% of MVPD subscribers still would have the opportunity to reach, through the remaining MVPDs, a number of subscribers well over the threshold for success.[3]

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[3] As it noted in its initial comments, TCI's proposal of a 40% limit takes into account TCI's proposed changes to the cable attribution rules which it advanced in separate comments on the Commission's Cable Attribution NPRM. Should the Commission decline to adopt changes to the attribution rules along the lines TCI has proposed, TCI maintains that a horizontal limit above 40% should be adopted by the Commission. This would be necessary to compensate for the application of the current attribution rules, which (as TCI demonstrated in its attribution comments) in many instances improperly attribute to an MSO the subscribers of cable systems even where the MSO holds only a minority interest and has no control over the programming decisions of such systems.

The economic analysis by Drs. Besen and Woodbury that TCI submitted along with its comments concluded that a horizontal limit significantly higher than the current 30% limit was justified in today's marketplace:

> We concluded [in 1993] that concerns about anticompetitive behavior by large cable MSOs had been exaggerated and that, therefore, the Commission need not adopt stringent limits on the ownership of cable systems. This earlier conclusion is buttressed by developments since the passage of the 1992 Cable Act and the promulgation of the Commission's rules -- most importantly the growth of Direct Broadcast Satellite subscribership -- which support a relaxation of the limits the Commission previously adopted. In addition, there is now empirical evidence about the carriage behavior of vertically integrated Multiple System Operators that was not available at the time the rules were adopted. This new evidence demonstrates that the concerns of the Congress upon which the rules are based are largely unfounded. Together, these considerations indicate that the Commission can significantly relax its cable ownership restrictions without being concerned that this will lead to anticompetitive behavior by large MSOs.[4]

Similarly, other commenters proposed a horizontal limit as high as 50%.[5] Each of these commenters provided strong arguments to justify relaxation of the current horizontal rules. In the next section, TCI responds to those commenters who argue that the current 30% limit should be retained or lowered.

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[4] Besen and Woodbury at 1 (emphasis added).

[5] See Comments of MediaOne at 29-30 (increase the limit to at least 35% of all MVPD subscribers and to 50% if the attribution rules are not revised to eliminate the double counting problem); Comments of NCTA at 19-23 (the Commission should emphasize antitrust analysis in revising the horizontal limit).

B. Commenters Urging The Commission To Lower Or Retain The Current Limit Rely On Purely Theoretical Concerns And Completely Ignore The Benefits of Larger MSO Size And The Changes In The MVPD Marketplace Since 1993.

1. No Commenter Justified Retaining Or Lowering The Current Limit.

A few commenters argue that the Commission should retain or lower the horizontal limit. Each of these comments shares the same shortcomings: They provide little more than theoretical concerns, "big is bad" rhetoric, and analyses that completely ignore the benefits and efficiencies associated with larger MSO size and the fundamental changes in the MVPD marketplace that have occurred since 1993.

a) RCN

For example, RCN urges the Commission to lower the horizontal limit from 30% to 20%.[6] This proposal is absurd in light of the fact that the Commission only two months ago in its reconsideration order affirmed that a 30% limit was appropriate in 1993. The proposal is particularly insupportable given the changes in the MVPD marketplace that have occurred since 1993. RCN ignores these changes and provides no evidence of any monopsony or vertical foreclosure abuses by large MSOs. Instead, RCN simply relies on bald assertions that the "bigness" of cable operators somehow impedes competition in local markets because larger cable operators are "willing and able to devote substantial financial, legal and

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[6] See Comments of RCN at 13-15.

other resources to impeding competitive entry, rather than to improving their services ...."[7]

RCN's argument appears to be that bigger firms are more prone to file lawsuits, etc. to prevent a new competitor from entering a market. These allegations are both unproved and irrelevant. This proceeding is about whether the benefits and efficiencies that will result from an increased horizontal limit outweigh any drawbacks in terms of possibly enhancing an MSO's ability to exercise monopsony power or to engage in vertical foreclosure. RCN's proposal to lower the limit to 20% is not even analyzed in these terms. For this reason alone, it should be rejected.

It is equally unclear how RCN's assertion that larger MSOs are more prone to raise their cable rates can be squared with its assertions that bigger firms make it more difficult for RCN to compete. Presumably if the big firms RCN is facing are raising their rates inappropriately as RCN suggests, RCN's ability to compete will be enhanced.

Moreover, RCN's attempt to link larger MSO size with higher cable rates is factually inaccurate. For example, last year, TCI's average rate increase across the country was one of the lowest in the cable industry -- 3.9%; in fact, due to competitive pressure, during 1998, on average across all of its regulated cable systems, TCI took price increases 6% below the maximum rate permitted by the Commission's rules.

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[7] Id. at 13.

Finally, RCN's suggestion that large MSOs engage in efforts to impede market entry as opposed to improving their services is belied by the significant system upgrades, channel additions, and new service options that TCI and other large MSOs have spearheaded in the industry.

b) Ameritech New Media

Ameritech New Media ("Ameritech") provides more of the same unsubstantiated claims and theories about the putative evils of larger MSO size. As an initial matter, TCI finds it to be the height of hubris for Ameritech -- one of the largest and most powerful corporations in America -- to be complaining about MSO size. Ameritech already controls approximately 23.8 million of the total telephone access lines in the United States.[8] If, as proposed, Ameritech merges with SBC Communications and Southern New England Telephone, its total access lines will approach 67 million -- more than the number of subscribers served by all cable systems in the United States combined.[9] Although Ameritech notes that it "does not believe that any particular market share, or level of horizontal concentration is per se anticompetitive,"[10] it is obvious that these are mere code words for saying that greater horizontal concentration is appropriate if it helps Ameritech to

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[8] See Preliminary Statistics of Communications Common Carriers, 1997 Edition, Table 2.10.

[9] Id.

[10] See Comments of Ameritech at n. 6.

compete but unacceptable if it enhances other companies' ability to enter Ameritech's markets and compete with Ameritech, for example, in its local telephony business. The Commission should recognize this duplicity for what it is and reject Ameritech's proposals accordingly.

There are also significant substantive problems with Ameritech's analysis. Most importantly, Ameritech's pleading is based almost entirely on theoretical concerns that are supported with speculation and assumptions. Ameritech's central criticism is that it takes approximately 20 million subscribers for a national program service to achieve viability, and if MSOs are permitted to increase in size this will afford MSOs a greater ability to extract concessions from program services on their way to this 20 million subscriber number.[11] Ameritech offers no evidence that increasing the horizontal limit would be at odds with a programmer's ability to achieve viability.

Indeed, TCI presented evidence to the contrary. TCI showed that many programming services have flourished at subscriber penetration levels well below 60% (the complement of TCI's proposed 40% limit). The Commission agreed with this analysis in its Second Order on Recon. when it determined that a programmer that could not obtain carriage on an MSO with 30% penetration could still reach over 50 million subscribers,[12] more than enough subscribers for a

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[11] See id. at 4, 14.

[12] The Commission calculated this result as follows: 73,646,970 (the number of MVPD subscribers cited in the Commission's 1997 (continued ...)

programming network to be a national success.[13] The same is true if the horizontal limit is raised to 40%. Under this approach (using updated subscriber figures), a programmer that could not obtain carriage on an MSO with 40% penetration could still reach almost 47 million MVPD subscribers[14] -- well above the 20 million number Ameritech cites as required for viability.[15] In fact, the Commission already has concluded that programmer viability can be achieved at subscriber numbers less than 20 million.[16] Thus, under

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(... continued)

annual competition report) minus 22,094,091 (30% x 73,646,970) = 51,552,879. See Second Order on Recon. at ¶ 45.

[13] Id.

[14] This is calculated as follows: 77,950,000 (the current number of MVPD subscribers, see NCTA Comments in Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming, Notice of Inquiry, CS Docket No. 98-102 (1998), at 6 (July 31, 1998)) times 60% (the percentage of subscribers served by MVPDs that are not affiliated with the MSO) = 46,770,000.

[15] See also Comments of TCI at 76-a for a chart listing examples of national programming services with subscriber penetration below 60%. Moreover, the Commission in its Second Order on Recon. points out that MSNBC, the Disney Channel, and Turner Classic Movies are among the top 50 programmers nationwide based on subscribership, and they reach substantially fewer than 40 million subscribers. Second Order on Recon. at ¶ 45.

[16] See 1996 Video Competition Report, 12 FCC Rcd 4358, at ¶ 135 (1997) ("The available evidence suggests that a successful launch of a new mass market national programming network -- that is, the initial subscriber requirement for long-term success -- requires that the new channel be available to at least ten to twenty million households."); see also 1997 Video Competition Report, 13 FCC Rcd 1034, at ¶¶ 155, 165 (1997) (citing 15 to 20 million as the critical number) ("1997 Video Competition Report"). Similarly, in the Commission's closed captioning proceeding, new cable programmers noted that the national subscriber penetration threshold that is typically required to attract advertisers (one of the keys to long-term viability) is 10 to 20 million. Further NPRM at ¶ 44 (citing Comments of Outdoor Life Network, Speedvision

(continued ...)

a 40% limit, even in the unlikely event that a programmer is entirely shut out of a particular MSO, the programmer still easily would have access to enough subscribers to achieve long-term success.[17]

Furthermore, in contrast to the theoretical concerns expressed by Ameritech, TCI provided empirical evidence showing that neither monopsony nor vertical foreclosure is a concern today, and that the possibility that they will be a concern in the future, even with an increased horizontal limit, is very remote.[18]

In addition to reviewing this empirical evidence, TCI asks that the Commission consider Ameritech's claims regarding the potential problems associated with larger MSO size against the following:

- Despite Ameritech's claims that an increase in the horizontal limit will harm programmers in the negotiation process (and thus also the downstream MVPD

(... continued)

Network, The Golf Channel, BET on Jazz, and America's Health Network at 11-13, 34, and 36, filed in Closed Captioning and Video Description of Video Programming, Implementation of Section 305 of the Telecommunications Act of 1996, Video Programming Accessibility, MM Docket No. 95-176)).

[17] See also Besen and Woodbury at 21 ("[E]vidence on the survivability of program services that are not integrated with cable operators provides many instances of services that [are] not vertically integrated [and] have existed for a very long period of time. Indeed, some of these are among the most successful program services."). In fact, according to certain projections, in a few years DBS operators alone will allow such a program service to achieve viability. See, e.g., Richard Bilotti, *et al.*, Telecommunications, Cable Television, Multichannel Metamorphosis II, Digital Derby-Rounding Turn #1, Morgan Stanley, Apr. 25, 1997, at 2 (projecting 15 million DBS subscribers by 2001).

[18] See Comments of TCI at 31-36.

market), not a single programmer filed comments in this proceeding opposing an increase in the horizontal limit;

- No party has filed a program carriage complaint against TCI or any other large MSO claiming that it has been mistreated, as Ameritech would now have the Commission believe; in fact, only a single program carriage complaint has been filed in the five years since the rules were adopted, and this case was settled;

- Not a single program access price discrimination or exclusivity case has been decided against TCI. In fact, in two recent situations, a non-cable distributor sought to offer services for which TCI had exclusive distribution rights. The first involved EchoStar's desire to distribute fX. The second involved Ameritech's desire to distribute ChicagoLand, a local service in the Chicago area. In the case of fX, TCI voluntarily waived its right to exclusivity. In the case of ChicagoLand, TCI voluntarily waived its exclusive rights to the Chicago Cubs baseball games carried on the service, which was the matter of particular interest to Ameritech.

In light of these facts and dynamics and the evidence supplied by TCI in its comments, it is simply not credible for Ameritech to assert that increasing the horizontal limit will lead to monopsony or vertical foreclosure abuses by larger MSOs.

The economic analysis attached to Ameritech's comments does little to cure the central flaw in Ameritech's comments, namely the lack of evidence to support its assertions. As Besen and Woodbury demonstrate in the responsive economic analysis attached to these reply comments, many of the statements made and conclusions reached by Drs. Dertouzos and Wildman ("DW") are incorrect, unsubstantiated, and, to a large degree, at odds with

statements that Dr. Wildman made in previous works. For example, as Besen and Woodbury point out:

> DW's conclusion that the estimated differences [in programmer prices] are due primarily to bargaining power on the part of large MSOs simply ignores ... many other legitimate reasons for the differences between top of the rate card and average fees per subscriber.[19]
>
> [E]ven if one accepted their results at face value, they do not support DW's conclusion that "it would be unwise to consider relaxing horizontal ownership restrictions...." In fact, their results support the opposite conclusion.[20]
>
> [C]arrying more services and charging lower prices can hardly be considered evidence of anticompetitive behavior. Moreover, even if DW were correct that these price differences are the result of bargaining power on the part of large MSOs, consumers clearly are the beneficiaries of this bargaining power.[21]
>
> Similarly, DW claim that TCI and Time Warner "favor their own networks at the expense of those provided by independent, non-vertically integrated programmers." However, the authors' own evidence clearly indicates that the increased carriage of vertically integrated services is <u>in addition to</u> and <u>not at the expense of</u> non-vertically integrated services. This evidence shows that TCI and Time Warner systems on average carry not only more networks in which they have ownership interests, but also <u>more independent networks</u> than do other systems, all things equal. This result is inconsistent with DW's conclusion that favoritism

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[19] Dr. Stanley M. Besen and Dr. John R. Woodbury, Charles River Associates Incorporated, "Comments on Dertouzos and Wildman, 'Programming Access and Effective Competition in Cable Television,'" September 3, 1998, at 11 (footnote omitted), attached to these reply comments as an Exhibit.

[20] <u>Id.</u> (footnote omitted)

[21] <u>Id.</u> at 12.

> by large MSOs reduces the number of independent voices available to viewers.[22]
>
> In short, DW have failed to make either a theoretical or empirical case for the proposition that existing MSOs are too large. Instead, their evidence indicates that large cable operators, including TCI, give their subscribers more service at lower prices than do small operators.[23]
>
> [T]here are few services that are available to cable but not to cable overbuilders or other competing MVPDs. If anything, the limited extent of permissible program exclusivity -- which is to say, virtually none currently for cable operators -- likely harms the development and growth of new and existing services. In any event, the Commission's program access rules appear to have been sufficient to ensure that MVPDs have access to virtually the entire array of program services available to cable MSOs.[24]

Ameritech's ultimate recommendation is that the Commission refuse to increase the horizontal limit or to relax the cable attribution rules until the program access rules are extended to non-vertically integrated and non-satellite programmers.[25] In other words, Ameritech is asking the Commission to deprive consumers of the additional benefits, efficiencies, innovation, and competition associated with larger MSO size until the Commission does what Ameritech already knows the Commission will not do.

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[22] Id. at 13 (footnotes omitted) (all emphases in original).

[23] Id.

[24] Id. at 21. Besen and Woodbury also point out that several of the arguments advanced by DW are squarely at odds with conclusions Dr. Wildman reached in prior works on the cable industry. See, e.g., id. at 14, 15.

[25] See Comments of Ameritech at 5.

First, the Commission only last month concluded that there was no evidence of any problem requiring the extension of program access to non-satellite services.[26] Second, the program access statute is limited to vertically integrated services, and it is beyond the Commission's authority to apply the rules to non-vertically integrated services.

Moreover, the cable industry has invested billions of dollars in programming. Ameritech has contributed exactly nothing. At some point, the Commission has to ask what cable's competitors are contributing to the programming business.

Of course, Ameritech's proposal is driven by other, entirely inappropriate motivations. If Ameritech's proposal will have any effect, it will be to forestall the ability of companies like TCI to continue their innovative investments in programming and technology and to launch competitive local telephony and interactive broadband services. A higher horizontal limit is particularly warranted to enable cable operators to obtain a network size sufficient to support and further promote the extraordinary investment in new technology and system upgrades required to provide these services to more American consumers.[27]

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[26] See Petition for Rulemaking of Ameritech New Media, Inc., Report and Order, CS Docket No. 97-248, FCC 98-189 (rel. August 10, 1998), at ¶ 71.

[27] As TCI noted in its Comments, one of the principal reasons AT&T is acquiring TCI is the significant regional clusters and the overall network footprint potentially represented by TCI's cable systems. See Comments of TCI at 53.

It is not surprising that Ameritech opposes this result. However, it is simply critical that the Commission not allow an unnecessarily narrow focus on vertical programming issues to hamstring the ability of companies like TCI to compete in this new broadband world. Purely theoretical concerns about monopsony and vertical foreclosure provide no basis to deprive a significant number of American consumers of the actual benefits of a vibrant competitor to their local telephone provider. It would be tragic if TCI were prevented from providing a consumer with competitive local telephony services because an incumbent local telephony provider was able to convince the Commission to retain a restrictive cable horizontal limit.

c) CU, *et al.*

Like RCN and Ameritech, Consumers Union, *et al.* ("CU, *et al.*") offer little more than unsubstantiated theories in support of their proposal to retain or lower the horizontal limit. For example, they state in conclusory fashion that "horizontal concentration is increasing, and reaching a critical point;" that "[e]xtending the horizontal limit will likely produce another rush to whatever new ownership limit the Commission may establish, thereby further diminishing competition;" and that "[h]igher concentration may give MSOs the market power to extract unreasonable concessions from program suppliers and to unfairly restrain competition from alternative distribution sources."[28]

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[28] See Comments of CU, *et al.* at 4-5.

CU, *et al.*'s central argument for retaining a strict horizontal limit appears to be that such a limit will "reduce the extent to which large MSOs can coordinate their behavior and forbear from overbuilding each other's markets."[29] In other words, CU, *et al.* believe that lower limits will facilitate more overbuilds which will drive consumer prices down. As Besen and Woodbury point out, however, this concern is unjustified:

> [W]hile it is theoretically possible that the threat of overbuilding may be reduced by the acquisition of cable systems by an MSO, that threat is not likely to be competitively important because there have been so few instances of overbuild competition.[30]

2. Scale Does Matter.

RCN and CU, *et al.* claim that greater horizontal concentration or "scale" is not a prerequisite for MSO investment in new programming services or deployment of advanced technologies.[31] However, as Congress, the Commission, and well-respected economists have consistently found, larger MSO size does create numerous benefits and efficiencies. For example, as the Commission recently noted, when Congress adopted the horizontal limit provision, it was well aware of the significant efficiencies that are produced by a larger network size:

> In adopting Section 613, Congress also recognized that multiple system ownership can benefit consumers. The House Report stated that cable

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29 Id. at 5.

30 Besen and Woodbury at 4.

31 See Comments of CU, *et al.* at 5; Comments of RCN at 12.

> industry consolidation has benefited consumers by allowing efficiencies in the administration, distribution and procurement of programming, and also noted that concentration of cable MSOs may help promote the introduction of new programming services by providing capital and a ready subscriber base for new services. The House Report also observed that large cable MSOs can take competitive and programming risks that smaller operators cannot. Similarly, the Senate Report acknowledged that horizontal concentration can create efficiencies from lower transaction costs in carriage negotiations between programmers and cable operators.[32]

Moreover, these benefits and efficiencies are not just theoretical. Concrete examples may be found across the cable industry. For example, TCI and other large MSOs have been responsible for the launch and funding of more program services than smaller cable operators. Similarly, TCI's size has enabled it to serve as a leader in the technology area. Ameritech criticizes TCI and other MSO's recent investment in General Instrument.[33] But this investment is part of a larger technology agreement that has made it possible to dramatically streamline the development, manufacture, and deployment of multi-purpose digital customer

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[32] Second Order on Recon. at ¶ 6 (citing Report of the House Committee on Energy and Commerce, H.R. Rep. No. 628, 102d Cong., 2d Sess. 43 (1992); Report of the Senate Committee on Commerce, Science and Transportation, S. Rep. No. 92, 102d Cong., 1st Sess. 34 (1991). See also Besen and Woodbury at 3-4 ("A program services' costs can be reduced significantly if it can deal with a single entity that negotiates on behalf of a large number of separate cable systems. ... With regard to innovation, large MSOs have historically played a significant role in developing new services, encouraging the introduction of services developed by others, and in supporting existing services through periods of financial difficulty.").

[33] See Comments of Ameritech at 24-25.

terminals that will deliver a myriad of new exciting services to American consumers, including a competitive local telephony offering.

In short, scale does matter. Besen and Woodbury reach the same conclusion regarding the significant additional consumer benefits associated with allowing cable systems to achieve a larger network size, particularly in terms of facilitating investments in innovative technologies and greater competition in the local telephony and other markets:

> [S]ignificant costs must be incurred to carry out the research and development activities that are necessary to permit Internet Protocol telephone over cable. However, small cable operators will not undertake these activities because they will capture only a small portion of the benefits that result from the development effort. Because the development activities are most likely to be undertaken by large cable operators, placing limits on the size of cable MSOs makes it less likely that these promising research and development activities, among others, will be undertaken. Moreover, size creates an additional advantage in bringing new technologies forward .... Many new telecommunications services that can be offered over cable require a significant degree of interoperability among different cable systems. For example, IP telephony will require uniform addressing systems and directory services to permit subscribers to one cable system to communicate with subscribers to another. Large cable operators are in a unique position to promote the development of industry-wide standards that will be needed to promote the development of these new services because they can be confident that other, smaller operators will follow their choices. The introduction of new services that require standardization is thus likely to be more difficult if cable system ownership is fragmented. Limiting the size of cable MSOs, by reducing the ability of any one cable operator to promote interoperability among cable systems, may threaten, or delay, the

introduction of new services by the cable industry.[34]

For these reasons, the Commission should disregard RCN and CU, *et al.*'s unsupported assertions that scale does not matter and should increase the limit to 40%, so that the additional benefits of larger MSO size -- in particular, the offering of competitive local telephony and interactive broadband services -- may redound to more American consumers.

III. THE COMMISSION SHOULD NOT RESTRICT CLUSTERING.

RCN urges the Commission to restrict the practice of cable clustering by adopting regional limits in addition to the national horizontal limit.[35] There are numerous reasons why the Commission should reject RCN's proposal.

First, the pro-consumer and pro-competitive benefits of clustering are well-established and well-recognized. As TCI described in its comments, in addition to increasing localized management, clustering fosters regional programming services, such as news and sports; improves maintenance and customer service; increases the ability on the part of cable operators to sell local and regional advertising; and enhances compatibility of set-top

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[34] Besen and Woodbury at 17-18 (emphasis added) (footnote omitted). See also Comments of AT&T at 10-11 ("In order to obtain a sufficient amount of local exchange customers to achieve the necessary economies, a new competitor may need to cover more territory than an ILEC because the CLEC's penetration level, especially during the initial period of construction and operation, will be much less than its established competitor.").

[35] See Comments of RCN at 19-20.

boxes. Perhaps most importantly, clustering will play a pivotal role in facilitating the creation of a truly competitive local telephony market. Clustering is essential to the efforts of TCI and other cable operators to compete effectively with geographically concentrated incumbent LECs and electric utilities because clustering substantially reduces the cost of providing local telephony.[36] The Commission, the Department of Justice, and NTIA all have found that clustering provides very significant economic benefits to consumers and clustered cable operators.[37]

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[36] For a more detailed description of the benefits and efficiencies of clustering, see Comments of TCI at 49-53 and Exhibit B.

[37] See 1997 Video Competition Report at ¶ 140 (explaining the many benefits of clustering including cost reduction, management efficiencies, increased attraction for advertising revenue, and enhanced position to compete with LECs and electric utilities in the provision of data transmission and local telephone service); Letter from Larry Irving, Asst. Secretary of Commerce, to the Honorable Janet D. Steiger, Chairman, Federal Trade Commission, Jan. 12, 1995 at 2 (voicing the strong opinion of the Administration that clustering is essential to the future of telecommunications and that any potential harms of clustering are "largely conjectural, speculative, or de minimis"). See also Reply Comments of the United States Department of Justice in Competition, Rate Deregulation and the Commission's Policies Relating to the Provision of Cable Television Service, MM Docket No. 89-600, at 44-45 (filed April 2, 1990) (noting that programming was increasing at the same time that MSO concentration was increasing and concluding that "there is considerable doubt regarding the basis for any regulation imposing generally applicable maximum size limits on MSOs"); Cable Attribution Comments of Adelphia Communications, *et al.* at 9-21 (describing the various benefits associated with the clustering deals between various cable operators); Cable Attribution Comments of Bresnan Communications Company, L.P. and TCA Cable TV, Inc. at 5-14 (same); Cable Attribution Comments of Cablevision Systems Corporation at 11-19 (same).

Second, RCN's "analysis" completely ignores all of the benefits and efficiencies of clustering and offers no contrary basis for stifling these benefits and efficiencies by imposing regional subscriber limits. Rather, RCN simply asserts that clustering enables a cable operator to enhance its "influence in the regional market" and cites as the only example of the asserted problems associated with clustering the fact that it "enables cable operators to deliver vertically-integrated video programming terrestrially, rather than via satellite [thereby] avoid[ing] the Commission's [program access] rules ...."[38] But the Commission just recently found that there is no evidence of a competitive problem with such migration of satellite services to terrestrial distribution for purposes of evading the program access rules.[39]

Third, given the well-established benefits and efficiencies of clustering and the absence of any justifiable contrary basis cited by RCN to restrict these benefits and efficiencies, the Commission's analysis for rejecting the imposition of regional subscriber limits set forth in its 1993 Order further supports rejection of RCN's proposal:

> [W]e find no basis in the record at this point for imposing regional limits that could reduce investment in the development of regional programming, upgraded cable infrastructure and improved customer service. We believe that the potential benefits and efficiencies of regional

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[38] See Comments of RCN at 19-20.

[39] See Petition for Rulemaking of Ameritech New Media, Inc., Report and Order, CS Docket No. 97-248, FCC 98-189 (rel. August 10, 1998), at ¶ 71.

> concentration outweigh any anti-competitive effects in the local programming or advertising marketplace. In fact, the record suggests that cable operators do not possess undue power in the local programming or advertising markets where they face competition from local broadcast stations and other multichannel program distributors. In the absence of record evidence suggesting that any cable operator possesses undue power in the local programming or advertising market, we conclude that it is unnecessary to adopt regional limits at this time.[40]

Finally, to the extent RCN's gripe is that clustering harms its ability to compete, its assertions are at odds with the facts. RCN has done exceptionally well in its video, voice, and data businesses even as cable clustering has occurred. RCN recently reported that its quarterly revenues increased 38%, customer connections are up 137%, and advanced fiber homes passed are up 94%. All types of services offered by RCN -- video, voice, and data -- have shown steady growth. Its residential video service connections jumped from 4,870 in the third quarter 1997 to 35,196 for the quarter ending June 30, 1998. Total service connections grew from 247,256 in the third quarter of 1997 to 709,988 in the second quarter ending June 30, 1998.[41] RCN's Chairman and CEO

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[40] Cable Ownership Limits Order, 8 FCC Rcd 8565, at ¶ 17 (1993) (emphasis added). See also id. at ¶ 16 ("Congress' objectives in requiring horizontal ownership limits -- to prevent the "concentration of the media in the hands of a few" and to limit the ability of MSOs to exercise undue market power in the program acquisition market -- can best be served by the adoption of national subscriber limits. Issues of regional concentration we believe would be better addressed by other provisions of the 1992 Act designed to promote the introduction of competition to established cable franchises.") (emphasis added).

[41] See "RCN Doubles On-Net Homes Passed; Advanced Fiber Connections Up More Than 135%," RCN Press Release, July 22, 1998.