stated in July of this year that "RCN has extended its advanced fiber network to more homes and added more on-net customer connections in the past 90 days than in all of the prior 12 months, combined.... Last quarter, we announced plans to ramp up construction in all of RCN's markets. These excellent results reflect this intensified build-out."[42]

In the end, RCN's proposal to limit clustering amounts to little more than a naked and self-serving plea for the government to impose a competitive handicap on its rivals. It should be summarily rejected by the Commission.

IV. THE COMMISSION SHOULD ADOPT AN MVPD SUBSCRIBER-BASED FORMULA.

TCI and other commenters demonstrated why moving to an MVPD subscriber-based formula is required to accommodate the significant changes that have occurred in the MVPD marketplace since 1993.[43] Certain commenters -- largely because they refuse to acknowledge the changed realities that confront them or because they mistakenly import a cable rate analysis into this context -- oppose including alternative MVPDs in the formula and/or changing the formula to a subscriber-based approach. TCI responds to each of these opposing comments below.

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[42] Id.

[43] See, e.g., Comments of TCI at 56-65; Comments of Time Warner at 27-32.

A. Replies To Parties Who Oppose The Inclusion Of Alternative MVPDs In The Formula.

1. RCN

In perhaps the most baseless proposal set forth in the comments, RCN supports inclusion of an MSO's MVPD affiliated subscribers in the numerator but not in the denominator of the horizontal formula. It claims that "no evidence exists to show that cable incumbents' power in the purchase and distribution of video programming has lessened over the last five years."[44] However, as TCI pointed out, there is new empirical evidence -- not available to the Commission when it adopted the current limit -- which demonstrates that concerns about monopsony behavior or vertical foreclosure are vastly overstated. In the economic analysis attached to TCI's comments, Drs. Besen and Woodbury analyzed this new data and concluded that "[t]he bulk of empirical evidence indicates that vertically integrated cable operators do not disfavor ... program services in which they do not have ownership interests."[45] Similarly, with respect to TCI, Besen and Woodbury found that "TCI does not favor affiliated programming services in any way that significantly forecloses non-affiliated programming."[46] To the contrary, Besen and Woodbury provided empirical evidence that "TCI actually favors non-affiliated

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[44] See Comments of RCN at 16.

[45] Besen and Woodbury at 19.

[46] Id. at A-1.

services."[47] Also, in its attribution comments, TCI showed that even if it were to have a 40% share of all MVPD subscribers, its ability to engage in vertical foreclosure still would be remote.[48]

Besen and Woodbury conclude that this new evidence, coupled with the growth of DBS and other non-cable MVPDs, "indicate that the Commission can significantly relax its cable ownership restrictions without being concerned that this will lead to anticompetitive behavior by large MSOs."[49]

In short, RCN's "no evidence" claim rings hollow.

This conclusion is further supported by the comments of TCI, NCTA, MediaOne, Time Warner, and others demonstrating that independent programming has flourished since the Commission adopted the horizontal limit in 1993. For example, the number of national satellite services has increased, from 106 in 1994 to 172 in 1997. During this same time, the percentage of programmers vertically integrated with cable has declined from 53% to 40%.[50]

The Commission itself recognized this growth of additional programming services in its Second Order on Recon.: "It appears that the current level of concentration among cable MSOs has not

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47 Id. at A-2 (emphasis in original).

48 Comments of Tele-Communications, Inc. in Implementation of the Cable Television Consumer Protection and Competition Act of 1992; Review of the Commission's Cable Attribution Rules, CS Docket No. 98-82, (filed Aug. 14, 1998), at Appendix A, Table 1.

49 Besen and Woodbury at 1.

50 See Comments of TCI at 28-30.

prevented an expansion in programming sources and networks."[51] It also recently observed a trend by existing service providers, regardless of whether they are vertically integrated with MSOs, to create additional programming services.[52] As the Commission's latest video competition report indicates, over 70 national programming services unaffiliated with cable operators are planned to be launched in the near future, whereas only 5 national programming services affiliated with a cable operator are planned for launch.[53] In short, contrary to the suggestion of RCN, the actual evidence demonstrates that independent programming sources have flourished over the last several years and that this activity is likely to continue. This evidence fully supports relaxation of the current horizontal limit.

RCN next suggests that the fact that the Commission recently adopted a damages remedy in program access cases proves that MSO anticompetitive power over programmers has increased because "[c]ertainly the Commission would not have felt it necessary to take these actions if the growth of alternative MVPDs has truly led

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51 Second Order on Recon. at ¶ 43.

52 1997 Video Competition Report at ¶ 164. For example, Viacom and the Walt Disney Company, program providers unaffiliated with any MVPD, recently launched additional programming services. Viacom's MTV recently launched M2, and Disney's ESPN recently launched ESPNEWS. See id.

53 See id. at Tables F-3 and F-4. See also discussion at pp. 9-11, supra, regarding the significant number of national satellite program services that have flourished even with subscriber penetration levels well below 60% (the complement of TCI's 40% subscriber limit proposal).

to a reduction in cable incumbents' market power in the purchase and distribution of programming."[54]

As an initial matter, RCN's view of the Commission's recent program access order reads too much into this decision. Nowhere does the Commission state that its decision to adopt a damages remedy in program access cases is based on widespread evidence of market power by large MSOs over vertically integrated programmers. In fact, the only statement the Commission makes regarding the need for a damages remedy is the following:

> [T]he Commission and the multichannel video programming industry have had almost six years of experience under Section 628, and the Commission believes that sufficient understanding of the parameters of program access exist. It is appropriate to take a logical next step -- the compensation of victims of clear-cut anti-competitive conduct which violates the program access rules.[55]

This statement is a far cry from a blanket indictment of the practices of large MSOs in the programming area as RCN now suggests. In fact, the Commission's other relevant statements on the program access rules actually run counter to RCN's argument. For example, the Commission has often cited the program access rules as a "necessary factor in the development of both the DBS and MMDS industries."[56]

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[54] See Comments of RCN at 16.

[55] 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 ¶ 17.

[56] 1997 Video Competition Report at ¶ 230.

In sum, RCN argues that the strengthening of the program access rules means that the Commission also should retain or lower the current overly restrictive horizontal limit. TCI suggests that precisely the opposite is the correct public policy choice. As TCI noted, and as the Commission has acknowledged, the success and strengthening of existing cable restrictions that address the very same behavior targeted by the horizontal limit -- such as program access, program carriage, leased access, channel occupancy, and must carry -- mean that there is less, not more, need to impose an overly restrictive horizontal limit on cable.[57]

RCN's final argument against inclusion of non-cable MVPDs in the denominator is that doing so would be unworkable because the fact that DBS is available to "virtually all television homes in the denominator would grossly distort the size of the MVPD market ...."[58] RCN fails to point out, however, that inclusion of DBS in the denominator of the formula is only a problem if the homes-passed approach is retained. If the Commission instead adopts a subscriber-based approach, inclusion of DBS subscribers in the

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[57] See Comments of TCI at 21-26. See also Second Order on Recon. at ¶ 50 ("Statutes and rules such as the program access, program carriage, channel occupancy limits, and must-carry requirements all affect the way the cable television industry currently operates and have a profound effect on current industry structure and performance. ... Because these provisions have real and substantive impact upon the market, the Commission, in setting the horizontal ownership limit, may properly consider the impact of these provisions in alleviating some of the public interest and anticompetitive concerns about horizontal concentration.").

[58] See Comments of RCN at 17.

denominator along with all other cable and non-cable MVPD subscribers will present no such "gross distortion" effect because the growth of DBS will affect the cable horizontal limit only to the extent that DBS attracts additional subscribers.[59] In short, the measurement "problem" raised by DBS is simply an additional reason why the Commission should move away from the current cable homes-passed to an MVPD subscriber-based approach.

2. CU, *et al.*

CU, *et al.* are the only other commenters who oppose including alternative MVPDs in the measure of horizontal concentration. Their principal objection is that "[b]ecause alternative MVPDs have not developed into full-fledged competitors to cable services, they should not be included in the calculation of the cable horizontal ownership limits."[60] The problem with this analysis is that it focuses on the wrong question. Like RCN, CU, *et al.* improperly attempt to import into this proceeding a debate about whether non-cable competition is sufficient to justify cable rate deregulation. But the question whether alternative MVPDs should be included in the cable horizontal formula does not and should not turn on this question or on whether alternative MVPDs have "penetrated U.S.

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[59] Even accepting RCN's argument on its face, it is still logically flawed: RCN fails to explain why it is that inclusion of DBS in the denominator is a real problem given DBS's 100% availability nationwide, yet apparently is no problem in terms of RCN's recommendation to include an MSO's DBS affiliates in the numerator.

[60] See Comments of CU, *et al.* at 8.

households to any degree comparable to the penetration of cable."[61] Rather, the question is whether these alternative MVPDs represent viable alternative outlets for programmers such that they have an effect on monopsony or vertical foreclosure concerns. As TCI said in its initial comments:

> Even if one does not believe that the current level of competition is sufficient to justify rate deregulation,[62] it seems obviously wrong not to take these non-cable MVPDs into account in specifying a cable horizontal limit, since they clearly affect an MSO's monopsony and vertical foreclosure powers. Yet, that is precisely what the current horizontal rule does -- it fails to give any effect to non-cable MVPDs. This failure leads to odd results. [For example,] [i]f an MSO today had 30% of all cable homes passed and tomorrow the DBS industry captured half of the MVPD marketplace, the MSO would still be at 30% of cable homes passed with no ability to grow. Yet, the MSO's power in the marketplace, and particularly its ability to exercise monopsony power or vertical foreclosure, clearly would have been reduced dramatically.[63]

Drs. Besen and Woodbury reiterated this conclusion:

> [T]he growth in DBS subscribership, as well as the growth in subscribership of other non-cable MVPDs, has reduced whatever ability large cable MSOs may have had to engage in the kinds of practices that gave rise to Congress' concern about concentration in cable ownership. In particular, by creating additional outlets through which program services can reach potential subscribers, the growth of DBS has reduced any ability that a large cable MSO might have either to foreclose rival program services or to exercise monopsony power. Because the growth of DBS and other MVPDs has substantially

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[61] Id. at 7.

[62] However, TCI notes that Congress felt sufficiently strong about the state of MVPD competition to deregulate cable rates as of March 31, 1999. See 47 U.S.C. § 543(c)(4).

[63] See Comments of TCI at 19-20.

> reduced the percentage of potential viewers that might be foreclosed by a large cable MSO, it is important to take that growth into account in establishing a cable ownership cap. Were the Commission to do so, the limit on the size of a cable MSO would be increased because DBS, along with other MVPDs, provides an alternative route through which a foreclosed programmer could reach virtually all television households.[64]

The Commission has also previously concluded in the 1997 Video Competition Report and again in the Further NPRM that non-cable MVPDs should be included in the horizontal formula:

> [A] true measure of horizontal concentration ought to take into account all MVPDs and MVPD subscribers, rather than cable operators and cable subscribers alone: '[I]n assessing the impact that national concentration may have in the MVPD programming market, we believe that it is appropriate to consider the presence of all MVPDs and MVPD subscribers in national concentration figures, and not just cable MSOs and cable subscribers. As non-cable MVPD subscribership increases, the significance of DBS, MMDS and SMATV operators in the MVPD program purchasing market also increases.' With the growth of alternative MVPDs, network programmers gain alternative avenues for distribution of their products, thus reducing cable operators' market power or influence in the purchase and distribution of network programming.[65]

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64 Besen and Woodbury at 23. See also id. at 8 ("[T]he effectiveness of a foreclosure strategy is further weakened if other distributors can carry a rival service the MSO tried to foreclose. In light of developments that have occurred since the passage of the 1992 Cable Act and the adoption by the Commission of rules limiting the size of MSOs -- especially the rapid growth in the number of subscribers served by DBS operators -- this factor places an especially important constraint on the ability of a large, vertically integrated MSO to foreclose a rival program service.").

65 Further NPRM at ¶ 80 (quoting 1997 Video Competition Report at ¶ 150). Aside from the fact that CU, *et al.* focus on the wrong inquiry, they significantly understate the competitive presence of DBS. They assert that DBS currently has 5.1 million subscribers (see Comments of CU, *et al.* at 7, citing an FCC report that is at (continued ...)

RCN and CU, *et al.*'s efforts to exclude DBS and other non-cable MVPD subscribers from the horizontal formula are especially insupportable when one considers that DirecTV (with 3.8 million subscribers) is now comparable in size to the fifth largest MSO -- Cox Cable. Stated another way, if Cox Cable is included in the denominator when measuring TCI's horizontal concentration, why should DirecTV be excluded, since DirecTV and Cox Cable have a comparable number of subscribers and thus constitute a comparable outlet for programmers?

Finally, the Commission should reject CU, *et al.*'s proposal to "recalibrate" the horizontal limit downward if MVPD subscribers are included in the formula.[66] This would simply have the effect of nullifying the inclusion of MVPD subscribers in the first place. While CU, *et al.* is correct that the inclusion of MVPD subscribers in the denominator would "allow cable operators to serve more subscribers under the new rule than they are allowed to serve under the present rule,"[67] this is how the formula is intended to work.

(... continued)

least 1 1/2 years out of date), when, in fact, the DBS industry reports subscribership of 7.42 million as of July 1998. See http://www.skyreport.com/dth_us.htm. Moreover, while a prudent way to take competition from non-cable MVPDs into account is to include non-cable MVPD subscribers in the cable horizontal formula, this approach is likely to understate the competitive constraint imposed by non-cable MVPDs because they can easily expand to serve additional subscribers if cable operators were to raise their prices. See Besen and Woodbury at 24-25 ("cable operators must respond to DBS' competitive significance, not its current market share.").

[66] See Comments of CU, *et al.* at 10-11.

[67] Id. at 11.

The whole point is that as the number of subscribers served by other MVPDs increases, MSOs should be able to increase the number of subscribers they serve. Certainly if under the current formula the number of cable homes passed in the United States increased by 12 million, CU, *et al.* would not and could not suggest that such an increase in the formula's denominator should trigger a corresponding downward "recalibration" of the horizontal limit. Rather, in such a situation, the number of cable homes an MSO would be permitted to pass would be greater than before the 12 million new cable homes were added to the denominator. There is no difference when the denominator is increased as a result of the addition of new non-cable MVPD outlets as opposed to new cable outlets.[68]

B. Replies To Parties Who Oppose A Subscriber-Based Formula.

RCN and CU, *et al.* oppose moving from the current homes-passed formula to a subscriber-based formula.[69] However, neither party provides a good reason why staying with the cable homes-passed formula makes any sense, particularly given the changes in the MVPD marketplace since 1993. Moreover, as TCI and other commenters demonstrated, an MVPD subscriber-based formula has several distinct advantages over a cable homes-passed formula, most importantly:

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68 This is especially true if the Commission decides to include in the numerator the subscribers of non-cable MVPDs with which an MSO is affiliated.

69 See Comments of RCN at 18; Comments of CU, *et al.* at 11-12.

(1) it takes into account the presence of non-cable competitors which clearly reduces the concerns underlying the limit; (2) it is a self-adjusting formula, so as competition continues to grow, the horizontal limit is automatically and appropriately revised; and (3) it is more accurate and easier to administer in today's more complicated MVPD marketplace.[70]

1. RCN

RCN's criticism of a subscriber-based test is that it would "artificially reduce the perceived influence of cable operators [because] [t]hough a cable operator may actually serve a relatively small percentage of the nation's homes, it is the number of homes passed by the operator that is the true measure of the operator's market influence."[71] Aside from the fact that these conclusory assertions provide no explanation of why a subscriber standard would "artificially reduce" an MSO's perceived influence or why a homes-passed standard is the "true measure" of the operator's market influence, RCN's assertions are at odds with marketplace realities.

As TCI and other comments demonstrated, a subscriber-based test is inherently more accurate than a cable homes-passed test in terms of measuring an MSO's influence over programmers because it focuses on the consumers that a cable operator <u>actually</u> <u>serves</u>. A homes-passed test, by contrast, looks at the number of <u>potential</u>

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[70] <u>See</u> Comments of TCI at 56-65.

[71] <u>See</u> Comments of RCN at 18.

customers which does not, and may never, correlate to the number of consumers an operator actually serves. This point is particularly relevant in the context of the horizontal rules. TCI, like most cable operators, deals with its program suppliers based on the number of subscribers it serves, not the number of homes it passes. Thus, in the real world, any monopsony or vertical foreclosure power that a cable operator could wield is related to subscribers, not homes passed. It therefore makes sense to amend the horizontal limit to reflect this fact.

The Commission already has recognized that a subscriber-based approach is more accurate than a cable homes-passed approach:

> While homes passed reflect the number of subscribers an MVPD has the potential of reaching, the MVPD often secures only a fraction of those potential subscribers. The MVPD typically does not purchase programming for all potential subscribers, only for those subscribers that it actually has. As alternative MVPDs continue to grow in the future, the number of homes passed by a cable operator may become an increasingly inaccurate measure of its actual subscribership and thus of its actual market power.[72]

2. CU, *et al.*

CU, *et al.* oppose a subscriber-based approach for two principal reasons, neither of which justifies retention of the homes-passed approach.

First, since CU, *et al.* believe that non-cable MVPDs should not be included in the formula, they dismiss as irrelevant the Commission's concern that as alternative MVPDs continue to grow,

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[72] Further NPRM at ¶ 84.

"the number of homes passed by a cable operator may become an increasingly inaccurate measure of its actual subscribership and thus of its actual market power."[73] However, as shown above and in the comments of TCI and others, inclusion of non-cable MVPDs in the cable horizontal formula is required in order to reflect the changed marketplace circumstances that have occurred since the current rule was adopted. Because the Commission acknowledges this in the Further NPRM, it must, a fortiori, reject this argument by CU, *et al.* in favor of a homes-passed test.[74]

Likewise, CU, *et al.*'s argument that a subscriber-based test may "have the effect of discouraging subscriber growth"[75] is equally unavailing. Continuing to view the world with blinders on, CU, *et al.* assert that "[b]ecause few cable operators face effective competition within their franchise areas, consumers may not be able to acquire cable programming from an alternative source."[76] While this statement may have been true in 1993, thereby justifying a cable homes-passed standard at that point, it simply ignores the realities that exist in the current MVPD

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73 See Comments of CU, *et al.* at 11 (citation omitted).

74 TCI also notes that there is no remaining question regarding the Commission's authority to adopt an MVPD subscriber-based formula, since no party questioned this authority in its comments and since TCI demonstrated in its comments that such a rule revision is well within the Commission's authority. See Comments of TCI at 62-65.

75 See CU, *et al.* at 12.

76 Id.

marketplace. The fact is that if an MSO does not seek to increase aggressively its subscribership as a result of its approaching the horizontal limit, the potential harm to consumers is significantly less than in 1993 because consumers now have access to viable alternative MVPDs, most notably DBS, in any market of the country. As Besen and Woodbury conclude:

> This concern [that a subscriber-based formula might create disincentives for subscriber growth for an MSO] is attenuated today, since cable systems face competitive alternatives in every area of the county, and households that are discouraged from subscribing to cable have other alternatives.[77]

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[77] Besen and Woodbury at n. 20. RCN and CU, *et al.* also ignore various other difficulties with a homes-passed approach, in terms of its accuracy, which have surfaced since its adoption in 1993. As TCI pointed out in its comments, the Commission has never specified the number of total cable homes that should be used as the denominator in the 30% calculation, and the Kagan study submitted by TCI indicated that the number of cable television homes nationwide could be anywhere from 96 million to approximately 115 million. Thus, it is extremely difficult to accurately measure horizontal ownership under the current rules. See Comments of TCI at 60-61. See also Comments of Time Warner at 28 ("many local cable systems do not keep accurate records of [homes passed] and [ ] local cable systems may utilize differing definitions of what it means to 'pass' a home in calculating their homes passed statistics."). By contrast, an MVPD subscriber-based approach would be easy to administer and update since the Commission, through its annual video competition reports, already tracks MVPD subscriber numbers.

V. CONCLUSION

For the foregoing reasons and the reasons set forth in TCI's initial comments, TCI respectfully urges the Commission to: (1) increase the horizontal limit to 40%; (2) adopt the MVPD subscriber-based test proposed in the Further NPRM; and (3) allow an MSO to grow internally beyond the 40% limit.

Respectfully submitted,

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EXHIBIT

COMMENTS ON DERTOUZOS AND WILDMAN, "PROGRAMMING ACCESS AND EFFECTIVE COMPETITION IN CABLE TELEVISION"

Stanley M. Besen and John R. Woodbury
Charles River Associates Incorporated

September 3, 1998

I. Introduction

In their paper, "Programming Access and Effective Competition in Cable Television,"[1] James Dertouzos and Steven S. Wildman (hereafter "DW") claim that there are sound theoretical reasons and empirical evidence for believing that complaints about program pricing and exclusivity by competitors of incumbent cable companies have merit. DW claim that entrants suffer from two handicaps: (1) they must pay higher prices than large incumbent cable operators for access to programming; and (2) large incumbents are able to deny entrants access to some programming either by acquiring exclusive licenses or by vertical integration.

DW further claim that the advantages that large cable operators enjoy are not grounded in superior efficiency and, therefore, are a barrier to effective competition in the supply of multichannel video services. DW conclude that the Federal Communications Commission's current program access protections are inadequate, and that the Commission's horizontal cable ownership restrictions and cable ownership attribution rules should not be relaxed without first addressing these concerns.

In this paper, we examine the evidence and analysis presented by DW. We conclude that this evidence and analysis do not provide a basis for the authors' conclusion that the current contractual arrangements between

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[1] Filed in MM Docket No. 92-264/CS Docket No. 98-82 as Attachment 2 to the Comments of Ameritech New Media, Inc., August 14, 1998.

programmers and cable operators constitute a barrier to effective competition in multichannel video distribution. We conclude, further, that DW have provided no evidence to support their view that the cable ownership rules should not be relaxed. Indeed, DW present evidence that large cable operators carry more program services – including program services in which they have no ownership interests – and charge lower prices than do smaller operators. Thus, contrary to DW's claim, their evidence shows that consumers would benefit from an immediate relaxation of the Commission's cable ownership rules, to the extent that the current rules have restricted MSO size.

The remainder of this paper is divided into two main sections. Section II considers DW's discussion of the pricing of program services. Section III addresses DW's discussion of exclusivity arrangements.

In Section II, we explain why DW's estimates of the discount obtained by large cable MSOs are likely to be highly inaccurate. Next, we explain why DW's attempt to ascribe virtually the entire estimated difference to bargaining power on the part of large MSOs is defective, and then offer a large number of cost and efficiency-based explanations for this difference.

Section II also analyzes DW's claim that their evidence demonstrates that large MSOs carry their own vertically integrated program services "at the expense" of services offered by independent suppliers. In fact, we point out that DW's own evidence indicates that large MSOs carry more of both integrated and non-integrated services. DW's evidence also shows that consumers benefit from lower cable prices as a result of any reductions in the prices large MSOs obtain from program services, regardless of the reason for those lower prices.

Section II concludes by considering the implications of the rate differences estimated by DW. We distinguish between bargaining power, which affects only the distribution of returns between cable operators and program services, and monopsony power, which affects the amount and prices of programming available to consumers. We then explain why large cable operators are unlikely to exercise monopsony power, because it will adversely affect the supply of programming available to them, and why consumers can, and do, benefit from the exercise of bargaining power in the form of lower prices for cable service.

In Section III, we examine DW's claim that program exclusivity presents a barrier to entry to new Multichannel Video Program Distributors (MVPDs). We show that virtually all important program services are available to new entrants, and that negotiation between entrants and programmers, as well as the Commission's program access rules, have proved adequate to deal with any concerns about program exclusivity.

II. Program Service Prices

DW argue that current programming price arrangements constitute a barrier to competition. First, they attempt to quantify the differences between the fees paid by larger MSOs and those paid by smaller MVPDs – the latter being the rates they argue a new entrant would have to pay. Second, DW purport to show that differences in rates as large as those they have quantified could not be based on cost, but instead must primarily represent the exercise of bargaining power by the larger MSOs. DW conclude that the result is to create a barrier to entry to new MVPDs.

There are problems with each stage of DW's argument. The authors' interpretation of the data on price differences and their analysis of the possible sources of differences in pricing are seriously flawed. Moreover, even to the extent that pricing patterns may reflect the bargaining power of large operators, this is unlikely to create a barrier to increased competition in multichannel video distribution.

A. The Magnitude and Sources of Program Pricing Differences

DW claim to have presented information on the magnitude of programming price discounts provided to large MSOs and then to have shown, by process of elimination, that such differences cannot be attributed to sources other than the bargaining power of such large MSOs. The fundamental problems with DW's analysis are: (1) their measures of the differences in the rates actually paid by larger and smaller MSOs are highly questionable; and (2) they fail to consider a wide variety of other reasons, including cost and efficiency-based reasons, for the calculated rate differences.

1. Reported Rate Card Discounts

DW first provide a summary of information from the rate cards for six networks. For each of these networks, DW report the number of subscribers required to qualify for minimum and maximum discounts, the magnitude of the maximum discount, and the length of the contract.[2] On the basis of this information, DW purport to calculate the dollar cost disadvantage that an entrant receiving no discounts would face compared to an incumbent receiving the maximum discounts.[3]

It is very doubtful that the results of these calculations can be interpreted as reliable estimates or indicators of cost disadvantages faced by an entrant. First, rate card fees may differ substantially from the fees negotiated and actually paid by MSOs. Many MSOs – not only the very largest – pay negotiated fees that differ from rate card fees.[4] Indeed, DW never actually claim that the rate card rates are being paid by anyone, including Ameritech, qualifying their calculations by noting that they are based on the assumption that "the rate cards were strictly adhered to."[5] If entrants such as Ameritech can negotiate rates that are lower than those in the rate cards employed in their calculations, DW's estimate of the cost disadvantage faced by an entrant (or a small cable operator) could be overstated.

Second, DW's calculations are based on the rate cards for only six networks; there is no way of knowing how representative this sample is because these networks are not identified.[6] Indeed, even among the six networks for which DW provide information, there are substantial differences both with respect

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[2] DW, Table 1, p. 5.
[3] DW, Table 2, p. 6.
[4] DW acknowledge that rate card fees may not reflect transaction prices, but see below for a discussion of the alternative set of data on which the authors rely.
[5] DW, p. 6.
[6] DW, p. 5.

to the magnitude of the maximum discounts offered and the number of subscribers required to qualify for those discounts.

Third, the magnitude of the maximum discount and the numbers of subscribers required to qualify for some discounts — and in some cases for the maximum discount — can be quite modest. Rate cards for 2 of the 6 networks are reported to offer maximum discounts of only 2.7 and 7.4 percent. One network offers a discount to an MVPD with only 1,000 subscribers, and two networks offer discounts to an MVPD with only 100,000 subscribers.[7] These are very modest numbers of subscribers for an entrant to reach, particularly an entrant seeking to compete in metropolitan areas, and no fewer than 49 cable MSOs would qualify.[8] For two networks, even the maximum discount is available to an MVPD that reaches as few as 2 percent of all MVPD subscribers.

2. Comparison of Rate Cards and Average Fees

DW recognize that rate cards may not reflect actual fees paid by distributors for programming, so they present alternative calculations based on data for basic cable networks reported by Paul Kagan Associates, which the authors claim are "more realistic" estimates of the cost disadvantage faced by entrants. Their analysis of these data and the interpretations drawn from these analyses are, however, seriously flawed.

For each of 19 basic cable networks, DW report the difference between the "top of the rate card" fee for 1997 and the reported average license fee paid

[7] All three of these networks are among those reported to offer large discounts.
[8] *Broadcasting & Cable Yearbook 1998*, Top 50 MSOs, p. C-10 indicates that there are 49 MSOs with more than 100,000 subscribers.

in 1997. DW then assert that there are only three "candidate explanations" for these discounts: (1) volume discounts to give MSOs an incentive to offer the networks to more subscribers,[9] (2) differences in the cost of supplying different networks, and (3) bargaining leverage by large MSOs. In fact, there are many other possible reasons for differences between the top of the card rate and the average fee per subscriber – reasons that DW do not consider in their analysis.

First, DW fail to consider that the top of the rate card fee and the average fee do not represent fees offered or paid at the same point in time. DW compare the top of the rate card rate *in* 1997 with the reported average rate paid by MVPDs *during* 1997. However, the average rate is based on contracts, many of which were entered into in years prior to 1997. Because rates for most services have been rising,[10] and because program service contracts extend over several years,[11] the average rate paid in any year (other things equal) will be below the top of the rate card rate in that year *even if there were no discounts*.[12] Thus, DW are not correct when they claim that their estimates "almost certainly understate

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[9] DW assert (p. 10) that "giving price breaks to incent system operators to make a network available to more of their subscribers is not a plausible explanation for strictly volume based discounts...." Of course, a discount-based on the subscriber volume delivered by the MVPD is distinct from a discount-based upon the percentage of the MVPD's subscribers delivered. However, the average fees paid by cable operators on which DW's discount calculations are based depend on the entire fee structure of the contract, not simply on the volume-discount provisions. If MVPDs pay lower per-subscriber fees because they increase the percentage of their subscribers that receive a service, DW's calculation would incorrectly ascribe the reduction to a volume-based discount. This is simply one manifestation of the authors' failure to recognize that program service contracts contain a wide variety of provisions affecting the prices that MVPDs pay.

[10] The top of the rate card rates for 5 of the 19 services examined by DW increased by at least 100 percent, and the rates for 10 of the 19 services increased by at least 50 percent between 1992 and 1997.

[11] DW (Executive Summary, p. 6) report that five-year contracts are "fairly common."

[12] Technically, the moving average of an increasing series will always be lower than the last term in that series.