programming for a share of total MVPD subscribers that is far too small to support any plausible argument that AT&T could engage in such conduct.

a. Competition from alternative MVPDs constrains the ability of any MSO to engage in vertical foreclosure or exercise monopoly power

Today, consumers can choose from a variety of multichannel video providers, including DBS, telephone companies, C-Band, multichannel multipoint distribution services ("MMDS"), Satellite Master Antenna Television Systems ("SMATV"), and utilities. More than 12.5 million consumers, representing approximately 16 percent of all MVPD subscribers, now obtain multichannel video programming from some company other than their local cable operator, and more can potentially do so.[102] This non-cable video competition means not only additional choices for consumers but additional outlets for video programmers, the existence of which necessarily constrains the ability of any MSO to exercise monopsony power or to engage in vertical foreclosure.[103] In the MVPD business, there are numerous actual and potential video

(. . . Continued)
exercise such power. In particular, the rapid growth of DBS provides program suppliers with an increasingly important alternative to cable operators for the sale of their services."); *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.").

[102] Order and Authorization, *Tempo Satellite, Inc., Assignor and DirecTV Enterprises, Inc., Assignee*, IBFS File No. SAT-ASG-19990127-00014, (FCC May 28, 1999) ("*Tempo Authorization*").

[103] *See Fourth Annual Video Competition Report* ¶ 150 ("[a]s non-cable MVPD subscribership increases, the significance of DBS, MMDS, and SMATV operators in the MVPD purchasing
(Continued . . .)

programming buyers that currently would be "at least as significant a force" as the combined AT&T-MediaOne.

The growth of cable's competitors has been steadily increasing for several years. For example, in its 1998 annual report on the status of competition in the video marketplace, the Commission noted that the number of subscribers to non-cable MVPDs grew 18 percent between June 1997 and June 1998, while cable subscribership grew by only two percent over the same period.[104] Industry analysts expect this trend to continue and have estimated that the number of non-cable MVPD subscribers will reach 17.8 million, or approximately 22 percent of all MVPD subscribers, by next year.[105]

DBS. DBS is a formidable competitor in the MVPD marketplace, offering over 200 channels that include all the most popular and widely carried national cable networks, as well as some programming (such as DirecTV's exclusive sports packages) that is not available to local cable systems. In addition, the up-front consumer equipment costs for DBS have plummeted from $700 five years ago to little or nothing today. As the Department of Justice has observed:

> Cable and DBS are both MVPD products. While the programming services are delivered via different technologies, consumers view the services as similar and to a large degree substitutable. Indeed, most new DBS subscribers in recent years are former cable subscribers who either stopped buying cable or downgraded their cable service once they purchased a DBS system.[106]

(. . . Continued)
marketplace also increases . . . thus reducing cable operators' market power or influence in the purchase and distribution of network programming.").

[104] *Fifth Annual Video Competition Report* ¶ 8.

[105] *See, e.g., Cablevision Bluebook, Volume IX*, at 10 (Summer/Fall 1999).

[106] Complaint, *United States v. Primestar, Inc.*, No. 1:98CV01193, ¶ 63 (D.D.C. May 12, 1998).

More recently, the Commission concluded, "*DBS operators and cable operators have engaged in increasingly rivalrous behavior, and . . . will likely increase the degree of that competition.*"[107]

The following additional facts about DBS further highlight that DBS operators are a significant outlets for video programmers:

- Two out of every three new MVPD subscribers choose a DBS operator over the local cable operator as their video programming provider;[108]
- Last year, DBS subscribership grew by 43 percent -- over 20 times faster than cable's subscribership growth during the same period;[109] and
- DBS operators have more subscribers than most cable companies they challenge. DirecTV (with 7.2 million subs) is now comparable in size to the third largest cable MSO; Echostar (with 2.4 million subs) is now comparable in size to the seventh largest cable MSO.

Various industry and regulatory developments will further enhance the competitive strength of DBS. First, DBS providers have begun to partner with other powerful companies in order to establish a presence in local communities and to enhance their service offerings. For example, DirecTV has signed marketing and distribution agreements with both Bell Atlantic and SBC to bundle telephone and video services to consumers.[110] Likewise, Echostar has signed strategic partnership agreements with private cable and competitive

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[107] Order and Authorization, *MCI Telecommunications Corp. and Echostar 110 Corp.*, FCC 99-109, ¶ 19 (FCC May 19, 1999) (emphasis added) (citing DOJ's comments filed in that proceeding) ("*Echostar Order*").

[108] *Fifth Annual Competition Report* ¶ 62.

[109] *Id.* ¶ 12.

[110] DirecTV News Release, "SBC Communications, DirecTV and USSB Sign Agreements to Offer Digital Satellite TV Service in Apartment Complexes," March 2, 1999, <www.directv.com/news/swbdeal.html>; DirecTV News Release, "Bell Atlantic, DirecTV and USSB Announce Agreements," March 2, 1999 <www.directv.com/news/badeal.html>.

residential phone service providers to bundle Echostar's satellite programming with other services, such as Internet access, telephony, and traditional cable television.[111]

Second, DirecTV recently acquired the United States Satellite Broadcasting Company ("USSB") and PRIMESTAR, which will add a significant number of new subscribers to DirecTV's totals.[112] More recently, the Commission approved the transfer of DBS licenses from Tempo to DirecTV, which will enable DirecTV to operate DBS satellites from three orbital locations that are capable of transmitting DBS signals to all portions of the U.S.[113] Indeed, the Commission justified its approval of the Tempo transfer by stating that it will:

> allow DirecTV to compete more effectively with EchoStar and cable operators [and] spur technical innovation by encouraging the satellite industry to develop small earth stations that can receive and integrate signals from multiple orbital positions, thus expanding programming choices for DBS subscribers, including under-served consumers.[114]

Similarly, the Commission noted that its approval of EchoStar's acquisition from MCI of 28 additional DBS channels at the full CONUS 110° orbital slot "will likely allow EchoStar to provide consumers with a more competitive alternative to cable offerings and thereby increase

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[111] Echostar Press Release, "Echostar, OpTel Form Alliance to Provide Dish Network Satellite Television Services to Multi-Family Residential Complexes," February 2, 1999, <www.dishnetwork.com/profile/press/press/press169.html>.

[112] DirecTV News Release, "Hughes to Acquire PRIMESTAR," January 22, 1999, <www.directv.com/news/dtvprimestar.html>; DirecTV News Release, "Hughes Completes Acquisition of PRIMESTAR Medium-Power DBS Business," April 28, 1999, <www.directv.com/press/pressdel/0,1112,5,00.html>.

[113] *See generally Tempo Authorization.*

[114] *Id.* ¶ 6.

competition in the [MVPD] market, which should lead to additional service offerings and/or lower prices."[115]

Finally, Congress's ongoing legislative initiative to authorize DBS providers to retransmit local broadcast signals within the broadcaster's local market will further enhance DBS's competitive significance by eliminating the primary reason why people say they do not subscribe to DBS.[116] According to information received by the Commission, 55 percent of individuals inquiring into DBS cited the lack of local broadcast signals as a reason not to purchase DBS.[117]

ILECs. Ameritech now passes more than 1.7 million homes in Illinois, Michigan, Ohio, and Wisconsin with over 100 cable franchises.[118] BellSouth has cable franchises passing 1.2 million homes in parts of the Atlanta, Birmingham, Charleston, and Jacksonville

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[115] *Echostar Order* ¶ 1.

[116] Both the House and Senate have approved bills that would allow satellite carriers to retransmit a local television station to households and businesses throughout that station's local market, as cable providers do currently. The House bill, H.R. 1554, was approved in April, and the Senate bill, S. 247, was adopted in May. The House and Senate are expected to complete work on the legislation later this summer. Given the pending enactment of this legislation, DirecTV announced plans to offer local broadcast network channels to approximately 50 million homes across the U.S. DirecTV Press Release, *DirecTV Announces Record April Subscriber Growth* (May 12, 1999) <www.directv.com/news/aprilperf.html>. The Commission has also paved the way for direct competition for domestic MVPD service by permitting DBS providers in Mexico and Argentina to provide service in the United States. *See* Public Notice, *International Bureau Announced Conclusion of U.S.-Mexico Protocol for Direct-to-Home Satellite Services*, 12 FCC Rcd. 13105 (1996); Public Notice, *International Bureau Announces Conclusion of U.S.-Argentina Framework Agreement and Protocol for Direct-to-Home Satellite Services and Fixed-Satellite Services*, DA 98-1114 (FCC June 12, 1998).

[117] *Fifth Annual Video Competition Report* ¶ 63.

[118] *ANM Launches in Two Ohio Towns*, Multichannel News, at 22 (May 17, 1999). Ameritech bills itself as the nation's largest competitive cable operator.

metropolitan areas,[119] and is a large investor in multichannel multipoint distribution services MMDS.[120] GTE has cable franchises in California, Florida, and Hawaii, that pass over 500,000 homes.[121] SNET has acquired the first state-wide cable franchise in Connecticut and is offering cable service in over a dozen communities.[122] U S West operates video systems in Omaha, Nebraska, and Phoenix, Arizona, the latter representing the first use of very high-speed digital subscriber line ("VDSL") technology to deliver video, high-speed Internet access, and telephone service over existing copper plant.[123]

In fact, the efforts of AT&T and other cable companies to upgrade and expand their networks are actually increasing the level of MVPD competition, as telephone companies seek to respond to cable's deployment of broadband technology and services. As explained in more detail below in Section V(G), ILECs are rapidly deploying DSL to provide a wide range of bundled broadband services to consumers.

Utilities. Electric utilities are entering the cable business. For example, RCN Corporation now provides bundled phone, video, and Internet-access services in New York, Boston, New Jersey, and Pennsylvania. It already has at least 63,000 video customers in Manhattan and Boston and recently expanded its cable service to Queens. RCN has also built a $300-million, 350-

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[119] *Fifth Annual Video Competition Report* ¶ 114. Other sources indicate that BellSouth passed 1.2 million households as early as August, 1997. *See Wireless Ops Oppose Nets' Program Access*, Multichannel News, at 35 (Aug. 25, 1997).

[120] *Fifth Annual Video Competition Report* ¶ 112.

[121] *Does GTE Provide Cable TV?* <www.gte.com/products/prods/americast.html>.

[122] *Fifth Annual Video Competition Report* ¶ 43.

[123] *Id.* ¶ 114.

mile fiber network in the Washington, D.C. region with a local utility, Potomac Electric Power Company, and is already providing similar bundled services under the brand name "StarPower" in the nation's capital.[124] Similarly, Seren Innovations Inc., a subsidiary of Northern States Power Co., Minnesota's largest electrical and natural gas utility, has begun offering cable and Internet service in Minnesota and has applied for cable franchises in markets served by AT&T in California and Colorado.[125]

Non-Cable MVPDs. While DBS and the delivery of services by telephone companies show the most growth as competitive alternatives to traditional cable companies, other MVPD providers also offer direct competition to cable operators in the MVPD marketplace. For example, C-band distributors serve over 1.8 million subscribers and provide access to several hundred program services.

Moreover, the provision of an additional 6 Mhz of spectrum to local broadcasters to launch digital broadcasting services will "allow broadcasters to become more effective competitors with cable operators in the MVPD market."[126] In fact, as early as November 1, 1999, more than half of all television households will have access to multiple channels of digital broadcast television.[127] By combining the digital spectrum of all stations in a local television

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[124] *Id.* ¶ 12.

[125] *Overbuilder Seren Could Stir Things In Denver*, Multichannel News, at 48 (June 7, 1999).

[126] *Id.* ¶ 101.

[127] Notice of Proposed Rulemaking, *Preemption of State and Local Zoning and Land Use Restrictions on the Siting, Placement, and Construction of Broadcast Station Transmission Facilities*, 12 FCC Rcd. 12504, ¶ 2 (1997).

market, broadcasters estimate that they will be able to create a 40 to 50 channel service to compete with existing MVPDs.[128]

In addition, MMDS operators currently serve approximately 1.5 million subscribers, and the Commission reports that the number of homes capable of receiving an MMDS signal grew to 34,000,000 at the end of 1997, an increase of 8 percent over the previous year.[129] Various companies are already taking advantage of the Commission's recent authorization of two-way digital MMDS[130] to offer high-speed Internet access, video conferencing, distance learning, continuing education, and other two-way services.[131] As noted by the Commission, its recent *Two-Way Order* provides MMDS operators with greater flexibility to provide service, which will further enhance MMDS' competitive potential.[132]

SMATV also compete aggressively with cable operators, primarily for multiple dwelling units. There are approximately 1.5 million SMATV subscribers.[133] New technological advancements, such as the use of common carrier supertrunking and the integration of DBS and

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[128] *Fifth Annual Video Competition Report* ¶ 101.

[129] *Id.* ¶ 83.

[130] Report and Order, *Amendment of Parts 21 and 74 to Enable Multipoint Distribution Service and Instructional Television Fixed Service Licensees to Engage in Fixed Two-Way Transmissions*, 13 FCC Rcd. 19112 (1998) ("*Two Way Order*").

[131] For example, BellSouth and GTE both launched digital MMDS systems in their regions in direct competition with cable operators. *Fifth Annual Video Competition Report* ¶ 81. Once all systems are launched, BellSouth estimates that it will be able to service more than three million homes. BellSouth News Release, *BellSouth Brings New Era of Home Entertainment Service to Atlanta* (June 4, 1998) <www.bellsouthcorp.com/proactive/documents/render/1726.html>.

[132] *Two Way Order* ¶¶ 8-9.

[133] *Fifth Annual Video Competition Report* ¶ 90.

SMATV services, will likely foster additional growth in the SMATV industry. SMATV operators also have begun to bundle local and long distance residential telephone services, closed-circuit security monitoring, Internet access, voice mail, and paging services in order to increase their competitive position *vis-à-vis* cable and other MVPDs.[134]

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The emergence and development of DBS and other significant competitors to cable means that programmers now have meaningful alternative outlets for distributing their product. The presence of these alternatives, and the fact that they are growing much more rapidly than cable, necessarily reduces any MSO's power to foreclose rivals or to obtain unfair concessions from programmers. As the Commission recently observed, "*[w]ith 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.*"[135]

b. AT&T-MediaOne will control far too few distribution outlets to engage in vertical foreclosure or exercise monopsony power

In analyzing the ability of an MSO to foreclose rival program services or to obtain anticompetitive concessions from programmers, the only relevant systems are those for which the MSO controls programming choices or buys programming. If an MSO cannot force a cable

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[134] *Id.*

[135] Memorandum Opinion and Order on Reconsideration and Further Notice of Proposed Rulemaking, *In the Matter of Implementation of Section 11(c) of the Cable Television Consumer Protection and Competition Act of 1992 - Horizontal Ownership Limits*, 13 FCC Rcd. 14462, ¶ 80 (1998) ("*Further NPRM*") (emphasis added).

system to decline to carry a rival program service, then the system is irrelevant to that MSO's ability to pursue a vertical foreclosure strategy. Similarly, an MSO derives no power to force anticompetitive concessions from a programmer based on a cable system for which it does not purchase programming, even if the MSO has a minority interest in the system.

After the Merger, AT&T will be involved to some extent in the purchasing or selection of programming for cable systems with approximately 21,206,000 subscribers. This includes all the subscribers for the AT&T and MediaOne cable systems identified in the charts contained in Appendices A and B, with the exception of those for which AT&T does not currently, and will not post-Merger, purchase programming or participate in making programming choices – *i.e.*, Cablevision, the two AT&T-Time Warner joint ventures (Kansas City Cable Partners and Texas Cable Partners, L.P., and TWE.[136] Based on a conservatively low estimated total MVPD subscriber base of 79,600,000,[137] AT&T thus would purchasing programming or participate in making programming choices for 26.6 percent of current MVPD subscribers.

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[136] Also, AT&T has subtracted 735,000 subscribers to account for systems that will be transferred to Comcast upon consummation of the Merger with MediaOne.

[137] *Tempo Authorization* ¶ 13. AT&T believes that using 79,600,000 MVPD subscribers is conservative. For example, Donaldson, Lufkin, Jenrette ("DLJ") recently estimated that there were 82,074,000 MVPD subscribers. *See Cablevision Blue Book, Volume IX*, at 10 (Summer/Fall 1999). Moreover, both the Commission and DLJ estimates are based on subscriber counts from last year, a significant fact given the growth rates for DBS and other non-cable MVPDs cited above. By way of example, consider that the Commission released its *Fifth Annual Competition Report* in December 1998, estimating 76.6 million MVPD subscribers, and only five months later, in the *Tempo Authorization*, adjusted that estimate to 79,600,000, an increase of three million subscribers.

Moreover, AT&T recently entered into three transactions that will further reduce its subscriber count: 1) the sale of its interest in Falcon Communications, L.P.; 2) the reduction below five percent of its interest in the cable systems currently owned by Bresnan Communications Co., Ltd. Partnership; and 3) the sale of its interests in certain cable systems to Cox Communications, Inc. When these transactions are completed, AT&T's subscriber count will be reduced to approximately 18,886,000 or only 23.7 percent of current MVPD subscribers. Similarly, Comcast, separate from the Comcast Exchange discussed above, has an option to acquire additional cable systems from AT&T. If Comcast exercises that option, then AT&T's percentage of MVPD subscribers would be even further reduced.

Even assuming that one could legitimately define a video programming input "market" limited to MVPDs – and, as discussed below, video programmers, in fact, have many other outlets for their products – there could be no conceivable monopsony power or vertical foreclosure concern at these levels. If AT&T refused to carry (or offered only anticompetitive purchase terms) to a video programmer, the programmer would still be able to obtain carriage on other cable systems serving "over 50 million subscribers, well over the threshold for national success."[138] AT&T has previously demonstrated that many programming services have had success with far fewer subscribers.[139] In fact, the Commission has recognized that networks can achieve long-term success with only 15 to 20 million subscribers.[140] The video programmer

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[138] *Further NPRM ¶ 45.*

[139] *See* TCI Ownership Limit Comments at 75-78.

[140] *See Fourth Annual Video Competition Report* ¶¶ 155, 165. Also, in the Commission's closed captioning proceeding, new cable programmers noted that it is necessary to have 10 to 20 million subscribers in order to attract advertisers (one of the keys to long-term viability). *See Further*

(Continued . . .)

would also retain access to the nearly 10 million subscribers currently served by DBS providers that, as noted above are already among the largest video programming purchasers. Indeed, even current AT&T subscribers would remain up for grabs through DBS providers, whose ability to capture those subscribers (by offering better content) would only be enhanced by any anticompetitive conduct by AT&T directed at video programmers. On these facts, there is no credible basis to conclude that AT&T post-Merger could foreclose rival programming services or exercise monopsony power – real world video programmers simply have too many alternatives.

Indeed, Applicants are aware of no precedent in *any* industry finding monopsony power with respect to a firm that purchases only twenty-five percent of the output of a given product. Even in cases involving concerted action by unaffiliated purchasers (and thus raising the specter of the very conspiracies in restraint of trade that the antitrust laws were designed to discourage), the Department of Justice has effectively established a "safe harbor" against monopsony power challenges when the firms in question account for less than 35 percent of total purchases, disposing of such matters through routine "Business Review" letters.[141] In the few

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NPRM ¶ 44 (citing comments of Outdoor Life Network, Speedvision Network, The Golf Channel, BET on Jazz, and America's Health Network).

[141] *See, e.g., Business Travel Contractors Corporation*, 1995 DOJBRL LEXIS 9 (July 14, 1995) (declining to challenge the plans of a Pennsylvania business travel corporation ("BTTC") to form a joint buying group to negotiate domestic air travel fares, finding that "[s]o long as BTTC's customers do not account for more than 35 percent of air travel purchases over any city-pair market, it is unlikely that BTTC would be able to exercise monopsony power to negotiate fares that are below competitive levels"); *IFA Shippers' Association*, 1990 DOJBRL LEXIS 2 (April 1990); *see also Utilities Service Alliance*, 1996 DOJBRL LEXIS 4 (July 3, 1996) (the Department "would challenge the formation or operation of a shippers' association that is likely to result in the exercise of power over freight rates in any relevant market ('monopsony power')", but "[t]his is unlikely where the membership's total projected shipments are less than 35 percent of the total transportation services supplied.").

single firm monopsony cases, the courts have consistently found that even much higher shares raise no competitive concerns, particularly where, as here, the sellers are sophisticated, large corporations. For example, in *United States v. Syufy Enterprises*, the court affirmed a summary judgment rejection of claims that a movie theatre chain that, during the relevant period, controlled as much as 75 percent of the Las Vegas market for first-run films was exercising monopsony power over Hollywood film distributors.[142] The same recognition that very high share is necessary to support any plausible claim is reflected in the vertical foreclosure cases as well (which have arisen primarily in the monopoly, not monopsony, context). *See, e.g., United States v. Aluminum Co. of America*, 148 F.2d 416, 424 (2d Cir. 1945) ("[I]t is doubtful whether sixty or sixty-four percent would be enough; and certainly thirty-three percent is not").[143]

Here, moreover, the approximately 25 percent share of current MVPD subscribers vastly overstates AT&T's post-Merger position with respect to video programmers. The entities that provide the overwhelming amount of video programming are large, sophisticated corporations that exercise substantial selling power through their control of unique, highly differentiated products. The very existence of MSOs and other MVPDs depends on obtaining

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[142] 903 F.2d 659, 663-71 (9th Cir. 1990). *See also* Jacobson & Dorman, *Monopsony Revisited*, Antitrust Bulletin 165 (Spring 1992) ("[T]he evidence is strong that true monopsony power is rare and that net adverse effects on price and output from monopsony are even rarer").

[143] *See also Arthur S. Langenderfer v. S. E. Johnson Co.*, 917 F.2d 1413, 1432 (6th Cir. 1991) ("[I]t would be rare indeed to find a firm with only 25 percent or 50 percent of the market could control price over any significant period."); I Antitrust Law Developments (Third), 213-214 (1992) (citations omitted) ("A market share in excess of 70 percent is almost always deemed sufficient to support an inference of monopoly power, although that inference may be overcome by other evidence. In contrast, a market share of less than about 40 percent virtually precludes a finding of monopoly power"); Areeda and Hovenkamp, ANTITRUST LAW 548-549 (1992 Supp.) ("[T]here is substantial merit in a presumption that market shares below 50 or 60 percent do not constitute monopoly power.").

programming that subscribers are willing to pay to receive. And now that over 95 percent of all television households have access to at least two to three competing MVPDs, cable systems must acquire the programming that their customers demand or they will lose subscribership to DBS and other competing MVPDs.[144] Nor are video programmers limited to selling their products to MVPDs. To the contrary, video programming service suppliers have many other outlets for their products, including broadcast, home video, and international markets.

Concerns that AT&T (or other MSOs) could impair the programming marketplace through vertical foreclosure are misplaced for additional reasons as well. Such conduct is already largely foreclosed by existing regulations, such as the program access, program carriage, must carry, leased access, and channel occupancy rules, which already prohibit discrimination and require the carriage of programming from diverse sources.[145] Further, it is important to recognize that TCI has previously supplied *empirical evidence* that it "does not favor affiliated programming services in any way that significantly forecloses non-affiliated programming."[146] Finally, AT&T would have no incentive to attempt vertical foreclosure even if it had the ability

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[144] *Tempo Authorization* ¶ 16. The substantial bargaining power that programmers enjoy by virtue of their exclusive control over popular programming networks and services is perhaps most aptly illustrated by the acceptance by even the largest cable MSOs of a 20 percent rate increase in the licensing fees charged by ESPN. Despite concerns that subscribers would not be willing to absorb this increase, the vast majority of large cable operators and cable MSOs retained ESPN. *See Id.* ¶ 174.

[145] The Commission has recognized that because these rules "all affect the way the cable television industry currently operates and have a profound effect on current industry structure and performance," it is appropriate "to consider the impact of these provisions in alleviating some of the public interest and anticompetitive concerns about horizontal concentration." *Further NPRM* ¶ 50. Moreover, these other behavioral restrictions have proven successful and, in some cases, have been strengthened since adoption of the suspended horizontal limit. *See* TCI Ownership Limit Comments at 21-25.

[146] Besen and Woodbury at A-1 *supra* n.101.

to do so. Any vertical foreclosure benefit to existing AT&T programming interests would not go to AT&T shareholders, but would go to Liberty shareholders. MediaOne's programming interests are virtually all minority interests, and thus, any gains to these new AT&T programming interests also would flow primarily to others. Yet AT&T would bear all of the substantial costs of the vertical foreclosure strategy – *i.e.*, reduced subscriber revenues that would flow from the reduced quality of its offerings occasioned by denying subscribers access to popular rival programming services.

In short, there is no basis for concluding that the Merger will give AT&T the ability to exercise monopsony power or to engage in vertical foreclosure.

3. The Commission's Suspended Horizontal Cable Ownership Rules, however they are Ultimately Resolved, should Not be an Obstacle to the Merger

AT&T recognizes that even beyond its competitive interest analysis, the Commission has an independent duty to assess the impact of a proposed transfer of control on the transferee's compliance with statutes and Commission regulations, including those addressing the ownership of cable systems. As the Commission is aware, however, the statutory cable horizontal ownership provision has been held unconstitutional,[147] and the Commission's cable horizontal ownership rule has been stayed.[148] Thus, the Merger currently would not result in a violation of the statute or the Commission's rule.

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[147] *Daniels Cablevision, Inc. v. U.S.*, 835 F. Supp. 1 (D.D.C. 1993).

[148] *1993 Ownership Order* ¶ 10. The stay of the notification provisions of the horizontal rule has been lifted, and AT&T has been complying with those requirements.

AT&T understands, of course, that the decision finding the statutory horizontal ownership provision unconstitutional is under appeal and that the Commission has initiated the *Further NPRM* on the horizontal rules and a related *NPRM* on the cable attribution rules.[149] AT&T will comply with all Commission rules. Regardless of the Commission's approval of the Merger, AT&T acknowledges that it will be subject to the general rules established in the ongoing rulemaking proceeding that is the subject of reconsideration and appellate review. While AT&T has supported the proposition that the Merger will not have anticompetitive effects on video programming services,[150] if, under rules the Commission adopts, AT&T exceeds the permitted level of horizontal ownership, it will either obtain an appropriate waiver based on the benefits to competition that will not otherwise be achieved, or bring itself into compliance with the rules.

With regard to the suspended cable horizontal ownership limit, AT&T and MediaOne, in the ongoing proceedings in the various rulemakings, have maintained that the

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[149] *Notice of Proposed Rulemaking, In the Matter of Implementation of the Cable Television Consumer Protection and Competition Act of 1992 - Review of the Commission's Cable Attribution Rules*, 13 FCC Rcd. 12990 (1998).

[150] Congress enacted the horizontal limit based on the concerns that cable operators could: (1) exercise monopsony power to force unfair concessions from programmers, *see* H.R. Rep. No. 102-628, at 42-43 (1992), and (2) vertically foreclose entry by programmers, thereby reducing program diversity. *See* S. Rep. No. 102-92, at 32 (1991). As the Commission has acknowledged, the purpose of the horizontal ownership limit relates entirely to the ability of cable operators to affect video programming. *See* Second Report and Order, *In the Matter of Implementation of Sections 11 and 13 of Cable Television Consumer Protection and Competition Act of 1992 - Vertical and Horizontal Ownership Limits*, 8 FCC Rcd. 8565, ¶ 10 (1993) ("*1993 Cable Ownership Order*") ("Congress concluded that [the] degree of [cable] concentration, though low relative to other industries, may enable some MSOs to exercise excessive market power, or monopsony power, in the program acquisition market. Congress was concerned in particular with preventing large vertically integrated cable systems from creating barriers to entry for new video programmers, and from causing a reduction in the number of media voices available to consumers.").

Commission should take the following approach: 1) consistent with the underlying purposes of the rules, attribute to an MSO only those cable systems for which the MSO controls programming choices or purchases programming; 2) consistent with the Commission's proposal in the *Further NPRM*, measure an MSO's horizontal concentration level as a percentage of all MVPD subscribers; and 3) for the reasons set forth in *TCI's* Horizontal Ownership Comments, significantly raise the 30 percent limit. Under this approach, as described above, AT&T would be involved in programming decisions or purchase programming for 26.6 percent (or 23.7 percent after the Falcon, Bresnan and Cox transactions close) of all MVPD subscribers nationwide.[151]

If the Commission instead were to consider AT&T's post-Merger horizontal concentration level on a cable homes-passed basis, then AT&T would be involved in programming decisions or purchase programming for cable systems with approximately

[151] AT&T and MediaOne today do not, and AT&T post-Merger will not, control programming choices or purchase programming for: Cablevision (3,149,000 subscribers; 5,126,000 homes passed); the two AT&T-Time Warner cable joint ventures (1,416,000 subscribers; 2,686,000 homes passed); and TWE (9,734,000 subscribers; 15,254,000 homes passed – after subtracting the two AT&T-Time Warner joint ventures, which are otherwise included in the TWE numbers). As pointed out above, these systems should not be attributed to AT&T because they do not give AT&T any ability to engage in vertical foreclosure or exercise monopsony power. In any event, the homes passed numbers should not be used as a measure because they do not take into account other MVPD competitors. As the Commission itself has proposed, horizontal concentration should be measured by MVPD subscribers, rather than homes passed.

34,760,000 cable homes passed,[152] or approximately 34.8 percent[153] of all cable homes passed. When the Falcon, Bresnan and Cox transactions are completed, AT&T will pass 31,015,000 cable homes, or approximately 31 percent of all cable homes-passed.

As shown above, market shares of this size are no cause for concern because they do not give firms the ability to engage in vertical foreclosure or to exercise monopsony power. Such a conclusion is consistent with Congress' decision in the 1996 Act to raise the national broadcast limit from 25 percent to 35 percent.[154] And, because the broadcast rules still allow for a discount for UHF stations, the effective horizontal limit for broadcasters is well above 35 percent.[155]

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[152] This includes all the homes passed for the AT&T and MediaOne cable systems identified in the charts contained in the Appendices, with the exception of Cablevision, the two AT&T-Time Warner joint ventures, and TWE. In addition, AT&T has subtracted from these numbers 1,155,000 homes passed to account for a reduction in homes passed resulting from the Comcast Exchange. As noted, Comcast also has a separate option to acquire additional cable systems from AT&T. If Comcast exercises that option, AT&T's percentage of cable homes passed will be even further reduced.

[153] This percentage is calculated by dividing 34,760,000 by 100,000,000 cable homes passed. However, the number may be substantially in excess of 100,000,000. Although a Kagan estimate of 95,520,000 total cable homes passed is sometimes cited, that figure is not appropriate for use in measuring an MSO's percentage of cable homes passed. TCI previously submitted to the Commission a separate study *performed by Kagan* indicating that the 95,520,000 estimate is unreliable and that the number could be well in excess of 100,000,000. *See* Letter from Michael H. Hammer, Esq., Willkie Farr & Gallagher, to William F. Caton, Secretary, Federal Communications Commission, *Ex Parte* Presentation, MM Docket No. 92-264 (Oct. 9, 1997). In fact, AT&T believes that given the significant changes in the MVPD marketplace over the past six years since the rule was adopted, the Commission could not now enforce a cable homes-passed test even if the suspended rules were reinstated. For these reasons, and the other reasons set out in TCI's prior comments, AT&T strongly endorses the Commission's proposal in the *Further NPRM* to use an MVPD subscriber test. *See* TCI Ownership Limit Comments at 56-65.

[154] 1996 Act, Pub. L. NO. 104-104, § 202(c)(1), 110 Stat. 56,111 (1996).

[155] 47 C.F.R. § 73.3555(e)(2)(i). For example, both Paxon and Fox have an effective national reach above 40 percent before applying the Commission's 50 percent discount for UHF stations.

(Continued . . .)

Moreover, the cable homes-passed measure completely ignores the considerable increase in the number of subscribers served by competing MVPDs, most importantly DBS, so that it vastly overstates an MSO's ability to engage in vertical foreclosure or to exercise monopsony power. Thus, if the Commission were to retain a homes-passed approach, it at the very least would have to modify its present formula to take into account the established competition from non-cable MVPDs, discussed above, both at present and going forward – *i.e.*, it would have to adopt a self-adjusting formula that would automatically recalculate an MSO's share as MVPD competition increases or decreases. Of course, the Commission could avoid the complexities of such a modified homes-passed approach by adopting the proposal in its *Further NPRM* to implement an MVPD subscriber formula.

In addition, whether measured on a subscriber or homes-passed basis, there is no concern that the Merger will reduce program diversity. First, as noted, AT&T post-Merger will not have sufficient size to enable it to foreclose programming services and thereby limit diversity. Second, the growth of DBS and other non-cable MVPDs provides programmers with additional viable distribution options. Third, as the Commission has found, independent programming sources have increased rapidly, and program diversity is at an all-time high.[156]

(. . . Continued)
Moreover, because LMAs are not attributable, the effective national reach of certain broadcasters is in the 60 percent range. *See* TCI Ownership Limit Comments at 71-72.

[156] For example, the number of national satellite services has increased from 106 in 1994 to 245 in 1998. During this same time, the percentage of programmers vertically integrated with cable has declined from 53 percent to 39 percent. *See Fourth Annual Video Competition Report* ¶ 158; *Fifth Annual Video Competition Report* ¶ 159. As the Commission recently found, over 70 national programming services unaffiliated with cable operators were planned to be launched in the near future, whereas only five national programming services affiliated with a cable operator were planned for launch. *See Fifth Annual Video Competition Report* at Tables F-3 and F-4.

Fourth, an MSO's ability to limit diversity by dictating content is substantially in check due to the Supreme Court's affirmance of the "must carry" rules in 1997. Finally, the emergence and widespread deployment of digital video technology by cable and non-cable MVPDs is increasing the number of programming outlets and creating additional incentives for the development of diverse new programming sources.[157]

AT&T recognizes that the suspended horizontal ownership rules and the underlying attribution rules attribute to an MSO even small minority ownership interests in cable systems whether or not the MSO buys programming for the system or controls the system's programming choices. AT&T believes this is an unjustifiable and unsupportable approach because such minority interests do not confer the ability to control programming that is at the heart of the horizontal ownership limit.

It is particularly important that the Commission modify the approach taken in the suspended horizontal rules given the high priority Congress placed on the development of local, residential telephone competition in the 1996 Act. AT&T is the only company to step forward with a commitment (and the extraordinary capital investment) to provide expansive, facilities-based alternatives to the ILEC monopolies. AT&T has proven that it stands ready to offer the benefits of telephone competition – lower prices, improved customer service, and technology innovation – to consumers across the nation. In fact, as one financial analyst report recently stated: "Besides AT&T, no other company has yet laid out a coherent plan for attacking a broad swathe of the Bells' residential business."[158]

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[157] *See also* TCI Ownership Limit Comments at 21-44.

[158] *New Communications Industry Takes Shape*, FT Telecoms, at p. 1 (June 9, 1999).

As discussed above in Sections IV and V(A), however, entering and competing in the local telephone business will be exceedingly difficult. The ILEC monopoly is over 100 years old, and the ILECs today still have virtually complete control over the residential subscribers in their territories. In addition, it is enormously expensive, technologically complicated, and labor intensive to upgrade cable systems to compete with the ILEC monopolies, and there is no guarantee that these investments will be successful. The Commission should not adopt cable horizontal rules that prevent AT&T from bringing local telephone choice to millions more consumers and from achieving the economies of scale and other benefits associated with large network size that are critical to providing alternatives to the ILEC monopolies.

The Commission has more than ample authority to adopt horizontal ownership rules that ensure that cable operators do not act anticompetitively in the programming marketplace, but at the same time encourage local telephone competition. In fact, the Communications Act compels such a balance. When Congress adopted the horizontal ownership provision in the 1992 Cable Act, it specifically instructed the Commission to take account of the fact that cable networks were evolving rapidly and had the potential to provide consumers with a vast array of new technologies and services.[159] When Congress spoke again in the 1996 Act, it emphasized most strongly the need to develop local telephony competition, and noted the unique role cable companies could play in developing such competition. The *only* way the Commission can harmonize the 1992 and 1996 Acts is to adopt cable horizontal rules that contain the

[159] For example, Congress mandated that the Commission "account for any efficiencies and other benefits that might be gained through increased ownership or control" of cable systems, 47 U.S.C. § 533(f)(2)(D), and that it adopt rules that "reflect the dynamic nature of the communications marketplace," *id.* § 533(f)(2)(E).

minimum limitations necessary to protect an increasingly competitive video marketplace, but do not hamper the growth that is necessary to stimulate local telephony competition.

Finally, if the suspended horizontal rules are reinstated, and if the Commission does not amend the rules in a manner that results in AT&T's compliance with the rules as adopted, AT&T could seek a waiver of the rules. A waiver clearly would be appropriate in those circumstances where competitive harms are nonexistent and there are enormous countervailing benefits that cannot otherwise be achieved.

Given that the proposed transaction threatens none of the competitive harms that the statute and horizontal rules were designed to address, and that it promises enormous public interest benefits – indeed, the only short-term prospect for real local telephone competition for millions of Americans – the horizontal ownership rules should not pose an obstacle to the proposed Merger. This is especially true where, regardless of how the ownership limits are ultimately crafted, AT&T will bring itself into compliance: AT&T will comply with whatever ownership limits emerge from the current judicial and Commission proceedings.

G. Internet Services

Internet access services allow consumers to connect with the global "network of networks" that comprises the Internet and World Wide Web. These services are provided by companies that combine a range of features including connectivity to the Internet and, in many cases, proprietary content.

AT&T provides its WorldNet Internet access service to approximately 1.8 million customers, out of an estimated 33.7 million Internet users nationwide.[160] AT&T also holds a 25.9 percent equity interest and a 57.9 percent voting interest in At Home Corporation, which provides Internet access services. AT&T offers the @Home service to approximately 74,000 subscribers in connection with cable operations. After the Merger, AT&T will also hold approximately a 35 percent interest in Road Runner, which also provides Internet access services. Through its ownership of MediaOne, AT&T will provide the Road Runner service to approximately 125,000 customers.

The provision of Internet access services is already highly competitive. Internet service providers ("ISPs") compete for customers across a wide variety of features and options, including transmission speed, content, and customer service. Literally hundreds of firms – including America Online ("AOL") (with about 18 million subscribers), Microsoft, the Bell operating companies, major satellite companies (including Hughes, Loral, and Lockheed), and dozens of other wireline and wireless firms – compete to provide consumers access to the Internet and to proprietary content compiled or developed by them or their partners.[161] In its *706*

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[160] According to numbers relied upon by the U.S. Department of Commerce, there are approximately 33.7 million Internet subscribers in the United States, although individual estimates of the market vary significantly from each other. *See* U.S. Department of Commerce, *The Emerging Digital Economy II* at 2 (June 1999) (citing <www.nua.ie/surveys>).

[161] The number of competitors is substantial. *See ACLU v. Reno*, 929 F. Supp. 824, 832-33 (E.D. Pa. 1996) (noting that consumers have a wide variety of avenues available by which to access the Internet, including AOL, Compuserve, the Microsoft Network, and Prodigy). *See also* Leslie Walker, *Rivals Cede Throne to AOL*, Washington Post, April 8, 1999, at E1 (naming some of the 4,000 companies providing dial-up access to the Internet); Boardwatch Magazine's Directory of Internet Service Providers, 11th Ed. 1999 (listing over 5000 ISPs).

NOI Report[162] and the order approving the AT&T-TCI merger just a few months ago, the Commission confirmed that "there are a large number of firms providing Internet access services in nearly all geographic markets in the United States, and these markets are quite competitive today."[163]

The Internet and online service business today is dominated by AOL, which serves almost 18 million of the total 33.7 million subscribers. By contrast, AT&T (through WorldNet and @Home) and MediaOne (through Road Runner) currently serve only 2 million and 125,000 subscribers, respectively. Current competitors are well-established, and new competitors are emerging regularly. Clearly, the broad range of choices available today demonstrates that the market is already extremely sensitive to the needs of consumers. Even focusing solely on Internet access services available over broadband facilities, there is no indication of potential anti-competitive effects. Consumers have an array of broadband choices, and these choices can be expanded easily by the entry of additional suppliers. In fact, the Commission has already found that "the preconditions for monopoly appear absent,"[164] and dozens of broadband competitors have entered the market even since that finding was made.

Importantly, the Merger will not have any effect on the ability of customers to access the Internet content of their choice. Concerns about the delivery of integrated cable Internet services are not merger-specific; in any case, such offerings promise numerous pro-competitive benefits to consumers. Because the Merger will enhance competition and create

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[162] *706 NOI Report* ¶¶ 7, 98.

[163] *AT&T-TCI* ¶ 93.

[164] *706 NOI Report* ¶ 48.

more "choice among video- and content- enriched high-speed Internet access services"[165] for consumers, it is demonstrably in the public interest.

1. The Internet Access Services Marketplace is Highly Competitive, and AT&T's Investment in Cable Systems will Make it More So

Internet access service is a product comprised of inputs, each of which is available from a wide range of firms. As a threshold matter, consumers need both "connectivity" with the Internet and "transport" between their premises and the connectivity provider.[166] Consumers then use the Internet to access "content" made available on servers connected to the Internet.[167] Companies may offer these three components individually or in a variety of bundles, but to the consumer they are all part of one service: access to the Internet.[168] With respect to any given set of Internet consumers, the relevant geographic markets are local. However, because the same

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[165] *AT&T-TCI* ¶ 147.

[166] The Commission has described Internet access as a combination of "computer processing, information storage, protocol conversion, and routing, with transmission," which allows users to access Internet content and services. Universal Service Report to Congress, *Federal-State Joint Board on Universal Service*, 13 FCC Rcd. 11501, ¶ 63 (1998) ("*Universal Service Report to Congress*"). For purposes of this statement, this component will be referred to as "connectivity."

[167] Content can include traditional text and graphic images, video, audio, and interactive services such as email and "chat."

[168] The Commission has identified various "categories" of Internet services, yet noted that many companies fall into more than one of these categories. *See Universal Service Report to Congress* ¶ 62 (distinguishing between access providers, application providers, content providers, and backbone providers); B. Esbin, *Internet over Cable: Defining the Future in Terms of the Past* at 17 (FCC OPP Working Paper Series No. 30, 1998) (explaining that it "is still possible to differentiate 'online service providers' from 'Internet service providers' or 'ISPs,' although the distinctions have grown blurred in practice.") ("*Internet Over Cable*").