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Michael H. Hammer

September 7, 1999

EX PARTE

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
445 12th Street, S.W., TW-A325
Washington, DC 20554

Re: CS Docket No. 99-251 (Application for Consent to the Transfer of Control of Licenses from MediaOne Group, Inc. to AT&T Corp.)

MM Docket No. 92-264 (Horizontal Ownership Limits)

CS Docket No. 98-82 (Cable Attribution Rules)

Dear Ms. Salas:

On September 7, 1999, Phil Verveer, Stan Besen and the undersigned, representing AT&T, met with Tom Krattenmaker and Howard Shelanski concerning the above-referenced proceedings. We discussed the need to conform the cable horizontal ownership and attribution rules to the programming concerns underlying the cable horizontal ownership statute. We also discussed the impact of the cable horizontal ownership and attribution rules upon the proposed merger of AT&T and MediaOne.

In addition, we agreed that we would provide Messrs. Krattenmaker and Shelanski with the attached documents.

An original and six copies of this letter are submitted herewith in accordance with Section 1.1206(b) of the Commission's rules.

Thank you.

Respectfully submitted,

Michael H. Hammer

cc: T. Krattenmaker
H. Shelanski

Washington, DC
New York
Paris
London

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 8-K

CURRENT REPORT

Pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934

Date of Report (Date of earliest event reported):
August 3, 1999

TIME WARNER ENTERTAINMENT COMPANY, L.P.
(Exact name of registrant as specified in its charter)

Delaware	**1-12878**	**13-3666692**
(State or other jurisdiction of incorporation)	(Commission File Number)	(I.R.S. Employer Identification No.)

American Television and Communications Corporation	Delaware	13-2922502
Warner Communications Inc.	Delaware	13-2696809
(Exact name of registrant as specified in its charter)	(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

75 Rockefeller Plaza, New York, NY 10019
(Address of principal executive offices) (zip code)

(212) 484-8000
(Registrant's telephone number, including area code)

Not Applicable
(Former name or former address, if changed since last report)

Item 5. Other Events.

Time Warner Entertainment Company, L.P. ("TWE") files this Report on Form 8-K to report that MediaOne Group, Inc.'s ("MediaOne") management and governance rights over all of TWE's businesses have terminated, as described below. This reduction in governance rights will result in Time Warner Inc. consolidating TWE's operating results and financial position for accounting purposes, which is expected to occur no later than the third quarter of this year.

On August 3, 1999, TWE received a notice (the "Termination Notice") from MediaOne, a holder of a limited partnership interest in TWE, concerning the termination of MediaOne's covenant not to compete with TWE. The termination of that covenant is necessary for MediaOne to complete its merger with AT&T Corp. As a result of the Termination Notice and the operation of the Partnership Agreement governing TWE, MediaOne's governance and management rights have terminated immediately and irrevocably to the fullest extent permitted by Section 5.5(f) of the TWE Partnership Agreement. As a result, MediaOne no longer has a vote on or any right to participate in the Cable Management Committee described on page I-21 of TWE's Annual Report on Form 10-K for the year ended December 31, 1998, and its representatives serving on TWE's Board of Representatives no longer have the right to vote on any matter pertaining to any of TWE's businesses. MediaOne retains certain protective governance rights on the TWE Board of Representatives pertaining to certain limited matters affecting TWE as a whole.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of New York, State of New York, on August 5, 1999.

TIME WARNER ENTERTAINMENT COMPANY, L.P.

By: WARNER COMMUNICATIONS INC.
As General Partner

By: /s/Christopher P. Bogart
Name: Christopher P. Bogart
Title: Vice President

AMERICAN TELEVISION AND COMMUNICATIONS CORPORATION
WARNER COMMUNICATIONS INC.

By: /s/Christopher P. Bogart
Name: Christopher P. Bogart
Title: Vice President

AN ECONOMIC ANALYSIS OF THE EFFECTS OF PARTIAL OWNERSHIP INTERESTS IN CABLE SYSTEMS

Stanley M. Besen, Daniel P. O'Brien, and John R. Woodbury
Charles River Associates Incorporated

Serge X. Moresi
Department of Economics
Georgetown University

August 14, 1998

I. Summary and Conclusions

We have been asked to comment on whether the Federal Communications Commission's (FCC's) ownership attribution rules for cable system operators should be altered to account more precisely for the degree of control or influence of an investor in a cable system for purposes of determining compliance with the (currently stayed) horizontal ownership limit.[1] The FCC's current rules attribute all homes passed by cable systems to cable system investors having at least a 5% financial interest. This limit caps the number of homes passed by any single cable system operator to no more than 30% of all homes passed by cable systems.

The FCC's homes passed cap and attribution rules together are intended to prevent common ownership of cable systems that might harm competition or diversity. In a separate and contemporaneous proceeding, the Commission is soliciting comment on the appropriate horizontal limits on common cable ownership.[2] For purposes of this report, we take the cap on the number of effectively controlled homes passed (or subscribers) served by any cable system owner as given.[3] The question we address here is whether the current attribution rules are appropriate.

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[1] Federal Communications Commission, 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, CS Docket No. 98-82 (released June 26, 1998) ("Attribution Notice").

[2] Federal Communications Commission, 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, MM Docket No. 92-264 (released June 26, 1998) ("Horizontal Notice").

[3] We address the appropriateness of the ownership cap in Stanley M. Besen and John R. Woodbury, "An Economic Analysis of the FCC's Cable Ownership Restrictions" ("CRA Ownership Report"), accompanying Comments of Tele-Communications, Inc. in response to the Horizontal Notice (submitted August 14, 1998).

We conclude that the Commission's current attribution rules should be modified to better reflect the nexus between the size of an ownership interest and the actual extent of influence or control conveyed by that interest. In particular, by effectively defining a controlling interest as a 5% ownership share, the rules classify many interests as attributable although they have no adverse consequences for competition or diversity. As a result, transactions that could benefit consumers may have been discouraged.

Our analysis also suggests that a higher, less restrictive attribution threshold would not increase significantly, if at all, the probability of consumer harm, would expand the sources of capital available to cable operators, and would permit the attainment of other efficiencies. There are two keys to understanding why the current rules are too restrictive.

First, it is important to distinguish among silent financial interests that convey no control, completely controlling interests, and interests that may provide partial control or "influence" over a cable system. Each of the these types of interests have different implications for the appropriate level of attribution because each has different implications for possible competitive harm. Further, the effects of each type of interest vary by the type of competitive concern that is raised. Thus, the appropriate number of homes passed to attribute to a particular cable system investor depends upon the particular circumstances of the acquisition.

The current rules do not appear to recognize or appreciate any of these distinctions. The Notice, like the rules themselves, greatly understates the

complexities involved in determining the extent to which a particular financial interest is silent, partially controlling, or completely controlling and ignores the differences in the effects these different types of interests may have. Similarly, the rules treat all competitive concerns identically, thereby ignoring distinctions that may be important for evaluating the competitive effects of any particular financial interest.

Although the analytical complexity of assessing the competitive implications of a financial interest suggests that a case-by-case approach may be the best substitute for the current rules, the administrative costs of this approach for the Commission and investors may be substantial. Our analysis indicates that any administratively simpler approach to attribution should create a more permissive environment for the acquisition of partial financial interests. In particular, even the acquisition of a large minority ownership interest that results in complete control may not impede the attainment of the Commission's policy goals. In addition, the most important competitive issue usually raised by partial financial interests—a potential reduction in competition among rivals in output markets—does not arise when cable systems take an interest in each other. Whatever set of attribution rules is ultimately adopted by the Commission for the cable industry, those rules should be more lenient than those for the broadcast industry where the rules must account for the fact that broadcast stations in the same local market compete with each for advertisers and viewers.

Second, the current rules likely discourage investments in cable systems that benefit consumers by artificially limiting the sources of capital available to

cable systems. They may also discourage practices that better align the incentives of cable systems and their input suppliers.

Section II addresses the distinction among financial interests and shows how the horizontal and vertical competitive effects generally depend on the type of interest and competitive concern considered. Section III illustrates how even large financial interests can be competitively innocuous. Section IV discusses the benefits that can flow from a more permissive attribution rule.

II. Distinguishing Among the Types of Financial Interests Is Necessary for An Evaluation of the FCC's Competitive Concerns

In determining compliance with the homes passed cap, the attribution rules prescribe how a cable operator should "count" its homes passed. Generally speaking, if a particular entity has an ownership interest of 5% or greater in a cable system, all of the homes passed by that cable system are "counted" as homes passed by the investor. The most important exception to this rule occurs if another investor has at least a 50% ownership share in the system, in which case the homes passed are not counted when determining compliance with the cap.

The Commission's articulated rationale for the subscriber cap and the attribution rules, which have been stated in numerous proceedings, is that excessive concentration in cable could harm competition in three ways. First, the Commission has expressed concern that concentration in cable could allow cable operators to exert monopsony power over cable programmers, leading to reduced prices for program services. Under this argument, increased common ownership of cable systems may permit the cable operator, unilaterally or in

coordination with other large cable operators, to bargain for lower program prices. Cable subscribers are harmed by this behavior if the effect of lower program prices is to reduce the quantity or the quality of program services.

Second, the Commission has expressed concern that common ownership of cable systems may impair diversity. One interpretation of this concern is that there will be excessive concentration in the "marketplace of ideas." Another is that commonly-owned systems will be programmed in a way that does not maximize the profits of the owner, but instead "slants" the carriage of services towards those consistent with a particular point of view.

Third, the Commission has expressed concern that common ownership among cable systems with programming interests could give an investor an increased incentive and ability to foreclose rival program services. For example, by acquiring an ownership interest in a cable system, an investor that also has programming interests may wield sufficient control or influence to induce the cable system to deny carriage to the investor's programming rivals.

In evaluating the implications of these concerns for purposes of the attribution rules, it is important to distinguish the financial interest the investor has in a firm—roughly speaking, the share of the firm's profits that are due the investor—and the control over the behavior of the firm conveyed by the financial interest. Specifically, the implications of a financial interest for the Commission's competitive concerns depend upon whether the financial interest conveys control over the behavior of the firm. In addition, they depend on the size of the financial interest, the competitive significance of the investor, and the competitive

significance of the firm in which the investment has been made (the "acquired" firm).

A. An Interest Resulting in Complete Control of the Firm

If an entity acquires an ownership interest in a cable operator that effectively permits it to control the operator, an argument might be made that the attribution rules should ascribe all of the households of the acquired cable system to the investing entity. However, the incentives for the investor to take actions that may benefit the acquired firm can be less than under a complete merger because the investor has less than a 100% share of the profits of the acquired firm. Thus, even in this case, one might want to attribute less than 100% of the acquired system's households to the investor, although a full competitive analysis would be required before such a conclusion could be reached.

At the same time, however, a rule that fully attributes the homes passed by an acquired cable system only if the investing entity has a majority interest may be too lenient. For example, if ownership is sufficiently dispersed, an investor may have control even with a minority ownership interest.

B. A Silent Financial Ownership Interest

A silent financial ownership interest in a cable system is one that does not afford the investor any control or influence over the management of the acquired system.[4] Thus, although the investor may alter its own behavior as a result of the

[4] The absence of control in a silent financial interest implies that the interest does not directly alter the incentives of the acquired system's management and therefore does not have a direct effect on diversity.

acquisition of the interest, but it cannot directly affect the behavior of the acquired system. While silent financial interests tend to be small interests, even a large interest can be silent if it is accompanied by (for example) binding commitments to insulate management from control by the investor.

C. Ownership Interests Conveying Partial Control or Influence

Finally, managers may respond to owners with large financial interests by accounting for the effects of their managerial decisions on the profits of those owners even if the owners do not exercise direct control over the cable system. For example, managers may believe that their job security or compensation is at risk if they take actions that adversely affect the profits of one or more owners with large financial interests. In this example, control of the firm is partial, because the extent of control of any individual owner depends on the magnitude of its interest, the magnitude of the interests of other large investors, and the source of profits of other large investors. Control of the firm is indirect, because it relies on managers having the incentives to serve the interests of large investors without explicit direction. However, partial control may be limited by the threat of shareholder suits that might arise if the managers must trade off gains to some shareholders against losses to others. The more conflicting the ownership interests, the more likely management is to focus on maximizing the value of the firm as a stand-alone entity.

D. Distinguishing Among Interests That Convey Silent, Complete, and Partial Control

There is a spectrum of financial interests, ranging from those that are completely silent to those that result in complete control and there is no simple

way to distinguish among them. An investor with a 51% ownership interest may lack effective control over the system because, e.g. there are covenants that insulate the system's management. In addition, if the majority owner were to take actions that increased its profits at the expense of other investors in the system, the directors of the acquired system may be subject to shareholder suits for violating their fiduciary responsibilities to other shareholders. The threat of such suits may limit even the effective control of an investor with a majority interest.

Whether a minority financial interest is controlling or silent requires additional scrutiny, such as an evaluation of size and significance of other shareholder interests, the composition and terms of the Board of Directors, identification of who has responsibility for hiring, firing and compensating management, and identification of covenants that restrict control. The power of a large minority shareholder may be limited by other large minority shareholders, or by a coalition of smaller shareholders.[5] Thus, in many circumstances, the size of the financial interest will be a highly imprecise indicator of the extent to which the financial interest conveys control.

If one could establish that a particular financial interest by one investor in a cable system conveyed complete control, then one might attribute the homes passed by that cable system to the investor. One would then evaluate the

[5] One way to measure the voting power of an owner is the Shapley Value Power Index. In this index, the voting power of any owner depends on the extent to which that owner's vote is crucial to attaining the preferred outcome of the owner. Using this index, it is often the case that an owner's voting power is diluted as the concentration of ownership among other owners increases. For a discussion, see L.S. Shapely, "A Value for N-Person Games," Annals of Mathematics Studies (1964). Some applications of the Shapely Value to voting can be found in G. Owen, Game Theory (1982), pp.197-198.

competitive significance of the financial interest by a competitive effects analysis. Of course, the Commission's abbreviated approach asks only whether control over this particular system results in the owner exceeding the homes passed cap.

The task of ascertaining competitive significance is more difficult for financial interests that are silent or convey partial control. How to attribute the households passed by the cable system in instances of less than complete control ultimately cannot be divorced from an evaluation of the competitive effects of the financial interest in question. Indeed, the correct attribution rule depends in part upon the potential competitive problem of concern, among many other factors. We explain below the considerations involved in addressing the significance of a financial interest when the investor and the acquired firm are horizontal rivals. We then consider the factors required for the evaluation of the competitive significance of a financial interest when there is a vertical relationship between the investor and the acquired firm.

E. Evaluating the Competitive Significance of a Financial Interest When the Firms are Horizontal Rivals

Consider a circumstance in which an investor acquires a minority ownership interest that conveys less than complete control. If the acquired firm and the investor compete for customers, i.e., they are horizontal rivals, then the intensity of price competition may be reduced (ignoring entry, the effect of other competitors, and other relevant market responses that may affect price competition). This occurs because if the investor competes less aggressively,

the profits of the acquired firm will rise and the investor shares in the higher profits by virtue of its financial interests. In addition, if the interest conveys some control, the acquired firm will also compete less aggressively, further increasing the profits of its investor.

The extent to which these incentives actually manifest themselves in reduced competition depends on a number of factors. A higher financial interest in the acquired firm yields a larger incentive to compete less aggressively (because the acquirer captures a greater share of the higher profits experienced by the acquired firm). The larger is the market share of the acquired firm, the greater is the increase in the profits of the acquired firm when the investing firm competes less aggressively. The greater is the market share of the investor, the greater is its profit when the acquired firm competes less aggressively. The greater the control conveyed by the financial interest, the larger will be the effects on suppressing competition. The more aligned are the interests of other owners, the larger may be the anticompetitive effect from the financial interest. For example, in the case of partial control, if other minority investors with partial control are also rivals of the acquired firm, the price effects will be increased because all investors benefit from reduced price competition.

Thus, in the specific case of one firm acquiring a financial interest in a horizontal rival, the direction of the competitive effects is clear—there will be less price competition. But whether or not the magnitude of the effect is empirically important depends on these other factors, as well as the competitive role of other rivals, entry, etc.

In an ideal world, determining whether a large financial interest has the potential for significant adverse competitive effects would be addressed on a case-by-case basis. However, if attribution rules are to be used, they should attribute a larger number of households to a cable system investor when the potential consumer harm is greater than when it is smaller. But that determination cannot be made without first evaluating the potential for harm. Indeed, as we illustrate below, the existing rules may permit less competitive transactions while proscribing more competitive ones. Thus, in terms of the likely competitive effects of the financial interest, there is no simple attribution rule that can capture the extent to which any particular financial interest would have the same competitive impact as completely controlling the acquired cable system.

F. Evaluating the Competitive Significance of a Financial Interest When the Firms Are in a Vertical Relationship

Assessing the competitive significance of a financial interest in vertical transactions is at least as complicated as the evaluation in the horizontal case. In this section, we consider two cases that illustrate those complications. In the first case, a cable operator with financial interests in a programming service acquires an interest in another cable system. The potential competitive issue is whether the acquisition increases the ability or incentive of the integrated cable operator to foreclose program services that rival its affiliated service.

In the second case, a cable operator with no program interests acquires an interest in another cable operator affiliated with a program service. The potential competitive issue here is whether the investing operator has an

incentive to foreclose rivals to the service with whom the investing operator has become indirectly affiliated.

Consider the first case. Suppose a cable operator with ownership interests in one or more program services acquires a financial interest in a cable system. If the interest conveys some degree of control over the acquired cable system, it may increase the ability of the investor to deny or reduce access to the acquired system by rivals of the investor's program services. The extent to which this is true depends upon (among other things) the magnitude of the ownership interest, the share of total subscribers accounted for by the investor, the share of total subscribers accounted for by the acquired system, and the extent of control conveyed.

Denying access may permit the investor to raise the price of its own program services. The extent to which this can occur depends on (among other things) the effect of the increased foreclosure on the competitive strength of the rival and on the strength of the competition from other program services.

However, the incentive to foreclose may also fall through the acquisition of a financial interest by one cable operator in another. For example, suppose the acquiring operator has only a partial ownership interest in programming. If foreclosure results in higher prices for the owned program services, the investor will experience higher programming costs for its cable subscribers and share in the higher costs experienced by the acquired cable operator. If the share of subscribers accounted for by the investor is large relative to its profit share in the programming service, the higher programming costs incurred by the investor may

exceed its program service profits. In this case, the financial interest may reduce the incentive to foreclose.

As another example, if subscribers to the acquired cable systems place a high value on the rival service, the denial of access to the rival service may result in losses to the investor as subscribers terminate their cable service. Thus, even if it increases the investor's ability to foreclose, the acquisition of a financial interest may not increase the incentive to foreclose, depending upon the additional profits from denying access as compared to the additional subscriber losses experienced through the investor's financial interest in the acquired system.

Note that if the financial interest is silent, the investor's ability and incentive to foreclose services that rival its own falls. This occurs because an increase in the price of the investor's service reduces the profits of the acquired cable system because the acquired system must pay higher program prices and the investor bears a portion of the reduction through its ownership interest.

If the acquired operator has an interest in a program service, the investor could deny the service's rivals access to its systems, thereby permitting the acquired operator's service to raise its prices. If the interest is silent, the investor shares in the additional profits earned by the service while bearing all of the subscriber losses from carriage denial.[6] If the interest conveys some control over the acquired system, the extent of foreclosure may increase if the acquired

[6] If foreclosure were the purpose of the acquisition of the silent financial interest, the investor could bypass the rules by taking an interest in the program service directly, rather than purchasing a financial interest in a cable operator with an interest in the service. In the context of vertical foreclosure, therefore silent financial interests should be completely non-attributable.

operator is induced to deny the rivals access to the acquired operator's systems. While the gains to the program service may increase as a result, the costs of the foreclosure strategy to the investor (increased subscriber losses and higher program service fees) will also increase.

As with the horizontal concerns, whether the acquisition of a financial interest raises vertical concerns can be determined only on a case-by-case basis, depending as it does on whether the interest is silent or (partially or completely) controlling, on the additional profits gained by foreclosure, and on the losses experienced as a result of foreclosure.

G. Summary

Distinguishing among silent financial interests, partially controlling interests, and completely controlling interests is important in identifying the likely competitive consequences of a partial ownership interest. However, the only way to make such a distinction is on a case-by-case basis. Moreover, for acquisitions that do not result in complete control, choosing how many of the acquired systems' households should be attributed to the investor cannot be divorced from the competitive consequences of the particular financial interest. In addition to the size of the interest, these consequences depend generally upon whether the relationship between the investor and the acquired firm is horizontal or vertical, and whether the financial interest is silent. These determinations, too, are most accurately made on a case-by-case basis.

The current FCC rules do not appear to account for these considerations. A financial interest of 5% in a cable system is treated as equivalent to complete

control. Yet, if the 5% is a silent interest or one conveying partial control, the extent of control will be much smaller, and the competitive effects will tend to be lower than if there were complete control.

Moreover, the precise competitive effects of any financial interest, and therefore the level of attribution that reflects the potential for competitive harm, depend upon the characteristics of the investor, the characteristics of the acquired firm, and whether the investor has a vertical or horizontal relationship with the acquired firm, in addition to the size of the interest. Thus, for example, the effects of a 5% financial interest, and therefore its treatment for attribution purposes, will depend on whether the investor is affiliated with a program service. By contrast, the current rules attribute all interests of 5% or more regardless of the circumstances.

Finally, the rules treat a 5% interest as equivalent to a 100% financial interest, but ignore smaller interests completely. In reality, of course, a 5% interest is likely to have the about the same competitive effects as a 4.9% interest, and the effect of both is likely to be far different from that of a 100% interest.

While our analysis suggests that a case-by-case approach is most likely to distinguish financial interests with benign competitive effects from those with adverse competitive consequences, that approach is likely to be administratively costly for both the Commission and investors, and therefore would discourage investment in cable systems. The analysis in the next section discusses why the competitive risks of partial financial interests may be small, and why, if the

Commission is to adopt attribution rules, they should be more permissive than the current rules.

III. The Current Cable Attribution Rules are Too Restrictive

The previous section outlined the complexity of evaluating the competitive effects of any particular financial interest, and therefore the difficulty of fashioning simple attribution rules that mirror that complexity. In this section, we describe why attribution thresholds considerably more lenient than the current rules are not likely to result in anticompetitive harm. First, we explain why the attribution rules used in broadcasting should not be used as a benchmark for the cable industry. Second, we illustrate how even very large financial interests in a horizontal competitor may not harm consumers. Third, we illustrate how even very large financial interests between firms in vertical relationships may not harm consumers.

A. The Cable Attribution Rules Should be Less Restrictive Than The Attribution Rules In Broadcasting

In the Cable Attribution Notice, the Commission seeks comment on "whether any relevant differences exist between the cable and broadcasting industries that would support a distinct cable attribution standard...to ensure competition and diversity."[7] An economic case can be made that the attribution rules for the cable industry should be less restrictive than those for broadcasting.

The broadcast attribution rules are intended to prevent the acquisition of financial interests that might harm competition and diversity in both local

[7] Attribution Notice, paragraph 13.

broadcast markets, where stations compete for viewers and advertisers, and in the national reach of broadcast station groups.[8] The Commission is concerned about local broadcast market competition because if one broadcast station acquires a silent financial interest in a rival broadcast station in the same geographic area, the investing station may have a reduced incentive to compete for advertisers and viewers. This is because some of the advertisers and viewers who would switch to the investing station if it lowered advertising rates or improved programming will be drawn from the acquired station. Because the investing station shares in the profits of the acquired station by virtue of its financial interest, its incentives to compete with that station are thereby reduced. Of course, the magnitude of this effect depends upon the particular competitive circumstances in which the two stations operate, e.g., it is likely to be more important if there are few competing stations, and it may be more significant if the interest conveys partial or complete control.

The potential for reduced competition in local markets is not relevant to cable. Because cable operators rarely compete with each other for subscribers, there is no possibility that the acquisition of any interest in another cable system will reduce the degree of competition among the systems for subscribers or for local advertisers. Thus, there is no risk that the investment of one cable system in another will result in higher prices to subscribers and advertisers as a

[8] The concerns addressed by the broadcasting rules are in Federal Communications Commission, Further Notice of Proposed Rulemaking In the Matter of Review of the Commission's Regulations Governing Television Broadcasting, MM Docket No. 91-211 (released January 17, 1995)

consequence of the suppression of direct competition between the two.[9] This suggests that the attribution rules for the cable industry should be more lenient than those for the broadcast industry. [10]

B. It is Unlikely That Buyer Power Will Harm Cable Subscribers

The effects of buyer power on consumers are ambiguous. The Commission itself has observed that the exercise of market power by cable operators could "result in lower negotiated programming costs."[11] Because programming fees are typically denominated on a per-subscriber basis, one effect of lower programming fees is to reduce the marginal cost (i.e., the incremental per subscriber cost) of cable service. This gives cable operators incentives to reduce the price of cable service. It is important to recognize that this incentive exists even if the cable operator has market power in the delivery of video program service within its service area, since even a monopolist has an incentive to pass-through some or all of any reduction in its marginal cost.[12]

To illustrate the potentially benign effects of a financial interest, suppose that the price paid by a cable operator will not affect the quality or production of the program service. The price that a program service is able to extract from a

[9] In principle, potential competition might be affected by financial interests of one cable operator in another. However, cable overbuilds are infrequent, suggesting that the effects on potential competition are trivial.
[10] The appropriate attribution policy for the broadcast industry might be one set of attribution rules governing the acquisition of an interest by one broadcast station in another in the same geographic market and another set of attribution rules for out-of-market acquisitions. In this case, we would expect that the latter set of rules to resemble those for the cable industry and to be more lenient than the former set of rules. It may be that both sets of broadcast attribution rules should be more permissive than the current rules. This is not an issue we have explored here.
[11] Horizontal Notice, p. 17.
[12] A monopolist with linear demand has an incentive to pass through 50% of a reduction in its marginal costs to its customers. A monopolist with constant elasticity demand passes through more than 100% of a reduction in marginal cost to its customers.

cable operator likely provides information to the service about the value of the program service to other cable operators as well. A cable operator that successfully bargains for a low price from the program service thus shares the benefits of that bargain with other cable operators. By acquiring a financial interest in other cable operators and thus sharing in the benefits created for other cable operators, the bargaining operator has a heightened incentive to bargain aggressively, thus reducing the price of the program service below what it would otherwise be.

Buyer power can have adverse consumer effects if lower programming prices reduce incentives for programmers to develop programming. This would occur if the costs of producing program services of any given quality increases as the number of program services produced increases, and if buyers are not able to engage in price discrimination by offering higher prices only for those programs that use resources with higher opportunity costs.

Specifically, in making its decision about how many program services to purchase, a competitive purchaser takes the program service price as given. Such a purchaser cannot affect the program service price because by assumption, it accounts for only a small fraction of program service purchases. An increase in the number of services it purchases has too small an effect on the total number of services produced to affect price.

By contrast, as the sole purchaser of program services, a monopsonist recognizes that more services purchased increase the cost of producing all

services. As a result, it tends to purchase fewer services than would a competitive purchaser.

As noted in the CRA Ownership Report, the history of program service entry and expansion suggests that program costs do not rise rapidly or at all as the number of services has increased. Thus, this type of monopsony power is unlikely to be of substantial competitive significance.[13]

In addition, concerns that program quality will fall as a result of increased cable bargaining power may be misplaced. Indeed, when program quality considerations are important, cross-ownership may result in reduced incentives to bargain for a lower programming price.[14] A cable operator with no such financial interests will ignore the effects on other cable operators of any reduction in quality induced by a lower programming price that it is able to extract. However, a cable operator with financial interests will take into account its share of the profits of other operators, and hence, has a smaller incentive to bargain for a lower programming price that reduces program quality. In other words, financial interests may mitigate incentives that cable operators have to exert monopsony power.

Finally, the ability to wield buyer power is diminished by the availability of alternative distribution outlets to whom program suppliers can turn if a single

[13] Even if the production of additional program services requires incurring higher costs than previous services, the monopsonist could continue paying the inputs of the previous services their opportunity cost, i.e., the minimum they would be willing to accept for their service, while paying the additional services a fee that reflects their higher costs. More technically, the monopsonist may be able to engage in first-degree price discrimination among program services, which eliminates the distortion that could otherwise accompany monopsony.

[14] In this report, "cross-ownership" means the acquisition of a financial interest in one cable operator by another cable operator or by an input supplier, such as a program service.