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October 1, 1999

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
445 Twelfth Street, S.W., TW-A325
Washington, D.C. 20554

Re: *Ex Parte* Submission of AT&T Corp.
MM Docket No. 92-264 (Horizontal Ownership Limits)
CS Docket No. 98-82 (Cable Attribution Rules)

Dear Ms. Salas:

Attached is a letter that AT&T delivered today to various Commission personnel. Please file a copy of this letter and attachment in the dockets of the above-captioned proceedings.

An original and four (4) copies of this letter and attachments are submitted herewith in accordance with Section 1.1206(b) of the Commission's rules.

Thank you.

Respectfully submitted,

Francis M. Buono

Francis M. Buono

Attachment

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October 1, 1999

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

The Honorable William E. Kennard
Federal Communications Commission
445 Twelfth Street, S.W.
Washington, D.C. 20554

Re: *Ex Parte* Comments of AT&T Corp.
MM Docket No. 92-264 (Horizontal Ownership Limits)
CS Docket No. 98-82 (Cable Attribution Rules)

Dear Chairman Kennard:

AT&T has submitted into the record in the above-captioned proceedings substantial economic, legal, and policy analyses that clearly justify an increase in the current cable horizontal ownership limit and the adoption of less restrictive attribution rules for the horizontal limit. Specifically, the evidence AT&T has submitted demonstrates that the Commission should: (1) adopt the MVPD subscriber test proposed in the *Further NPRM*;[1] (2) raise the cable horizontal ownership limit to at least 40 percent;[2] and (3) adopt an attribution rule under which an MSO would not be deemed to have an attributable interest in a cable system for horizontal ownership purposes where the MSO certifies to the FCC that (i) it does not buy programming for the system;[3] and (ii) it is not involved in the programming decisions of the system.[4]

[1] *See* TCI Comments filed in MM Docket No. 92-264 on August 14, 1998, at 56-65 ("TCI Ownership Comments").

[2] *Id.* at 65-78.

[3] Because an MSO would derive no additional buying power from a cable system for which it does not purchase programming, this requirement directly addresses any concern that an MSO could use a minority interest in a cable system to obtain unfair concessions from programmers (monopsony power).

[4] This requirement directly addresses any concern relating to vertical foreclosure and reducing program diversity. If an MSO agrees not to be involved in a cable system's
(footnote continued ...)

For example, in 1998 AT&T submitted two extensive economic studies which provide strong empirical support for its proposed changes to the cable horizontal ownership and attribution rules. The principal conclusion of the first study is that marketplace developments since 1993 and new empirical evidence not available to the Commission in 1993 "indicate that the Commission can significantly relax its cable ownership restrictions without being concerned that this will lead to anticompetitive behavior by large MSOs."[5] The second economic study undertook a comprehensive review of the Commission's attribution rules and the underlying purposes of the cable horizontal ownership limit and concluded that "the attribution rules for the cable industry should be more lenient than those for the broadcast industry."[6]

AT&T's proposed rule changes are further supported by the significant increase in local telephony, Internet, and other facilities-based competition that such changes would facilitate. 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 systems were evolving rapidly and had the potential to

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(... footnote continued)
programming choices and not to have access to any information regarding such programming, it cannot pursue a strategy of foreclosing a rival program service on that system or of slanting the programming toward the MSO's viewpoint. See Reply Comments of AT&T/MediaOne filed in CS Docket No. 99-251 on September 17, 1999, at 51-52 ("AT&T/MediaOne Reply Comments"). Under separate cover, AT&T has filed a copy of these reply comments on the AT&T/MediaOne merger (as well as the accompanying economic and other appendices) in the record of the above-captioned proceedings.

[5] *See* Stanley M. Besen and John R. Woodbury, Charles River Associates, "An Economic Analysis of the FCC's Cable Ownership Restrictions," August 14, 1998, at 1 (filed as an attachment to the Comments of TCI filed in CS Docket No. 92-264 on August 14, 1998).

[6] *See* Stanley M. Besen, Daniel P. O'Brien, John R. Woodbury, and Serge X. Moresi, Charles River Associates, "An Economic Analysis of the Effects of Partial Ownership Interests in Cable Systems," August 14, 1998, at 18 (filed as an attachment to the Comments of TCI filed in CS Docket No. 98-82 on August 14, 1998).

provide consumers with a vast array of new technologies and services.[7] When Congress spoke again in the 1996 Act, it emphasized the need to develop local telephony and broadband competition, and noted the unique role that cable companies could play in developing such competition. Under these circumstances -- where Congress has placed such a heavy emphasis on the development of local telephony and broadband competition, and the ability of MSOs to expand their ownership of cable systems is so obviously critical to achieving that goal[8] -- it is imperative that the Commission reexamine its suspended horizontal ownership rules from this broader perspective. Purely *theoretical concerns* about monopsony and vertical foreclosure provide no basis to deprive a significant number of American consumers of the *actual benefits* of a vibrant competitor to their local telephone provider.[9]

In short, the record in these proceedings fully justifies adoption of AT&T's proposals for a 40 percent horizontal ownership limit and less restrictive attribution rules. Indeed, given the competitive realities of the current MVPD marketplace, even a 40 percent horizontal ownership limit would be arbitrarily low if the Commission were to decline to modify the attribution rules. In that event, the

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[7] 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).

[8] AT&T has explained in detail why the benefits of such local competition cannot be achieved through joint ventures or other contractual arrangements. *See* AT&T/MediaOne Reply Comments at 18-23.

[9] In this regard, AT&T notes that the Commission recently adopted revised broadcast ownership and attribution rules which allow a single broadcaster to reach substantially more than 35 percent of all television households. Because the national broadcast ownership limit still applies a 50 percent discount for UHF stations and does not attribute -- or aggressively grandfathers -- LMAs (as well as same-market satellite TV stations), the effective national reach of certain broadcasters in some instances is in the 60 percent range. *See* TCI Ownership Comments at 71-72. If an effective national ownership limit well in excess of 40 percent is not too high to cause concerns about monopsony, vertical foreclosure, diversity, or coordinated activity in the case of "uniquely important" broadcasters (using the Commission's own terminology), *a fortiori*, it cannot reasonably be viewed as a problem for the cable industry.

horizontal ownership limit should, for the reasons given in the attached economic report of Dr. Janusz A. Ordover, be increased significantly above 40 percent.

Please feel free to call me should you have any questions or need further information on any of these issues.

Sincerely,

Mark C. Rosenblum / FMB

cc: Commissioner Susan Ness
Commissioner Michael K. Powell
Commissioner Harold Furchtgott-Roth
Commissioner Gloria Tristani
Deborah Lathen
Bob Pepper
Howard Shelanski
Chris Wright
Magalie Roman Salas, Secretary

Attachment

The Perils Of Static Analysis Of Unduly Narrow "Markets": Why Even A Cable MSO That Served 45 Percent Or More Of All Current MVPD Subscribers Would Pose No Threat To Video Programmers Or Consumers

Janusz A. Ordover[1]

I understand that the Federal Communications Commission is reviewing its existing horizontal cable ownership limit rules, which, if enforced, would prohibit a cable multiple systems operator ("MSO") from serving more than 30 percent of cable "homes passed." I understand that the Commission has proposed to abandon the "homes passed" criterion in favor of a more economically meaningful measure – an MSO's share of total multichannel video programming distributor ("MVPD") subscribers – but that opponents of changes to the rules ("Opponents") have raised monopsony power, vertical foreclosure and diversity of viewpoint objections to proposals that the 30 percent cap be raised.

As I explain below, these objections largely ignore the critical competitive market realities and rapidly changing technologies that would defeat such strategies even if attempted by an MSO with 45 percent or more of current MVPD subscribers. Arguments to the contrary reflect two basic (and, unfortunately, quite common) analytical errors: (1) a failure to look beyond static share figures to the full range of competitive options open to sellers and buyers in dynamic markets characterized by vast capacity to deliver video content to the public, and (2) a failure to engage in economically rigorous market definition analysis.

[1] Professor of Economics and Director of MA Program, New York University; former Deputy Assistant Attorney General for Economics, Antitrust Division, United States Department of Justice.

For purposes of my analysis, I posit a cable MSO with full ownership and control of cable systems that serve 45 percent of all current MVPD subscribers (which, I understand are estimated to total approximately 82 million customers). This is a conservative assumption given that the Commission's existing and proposed rules could, I understand, attribute to a cable MSO all subscribers from systems in which the MSO holds only small minority interests and is not even involved in programming choices.

For purposes of my analysis, I also ignore (as do opponents of an increased cap) the substantial public interest benefits that are likely to flow from a regulatory regime that allows cable companies the flexibility to grow and compete effectively with (and on the same scale as) monopoly local exchange carriers ("LECs") and other dominant suppliers. These public benefits include not only the direct benefits of increased local telephone and online services competition but also the creation of strong facilities-based competitors that will be well-positioned to prevent the incumbent LECs from extending their dominance to new and emerging services. I have addressed the nature and scope of these benefits in detail elsewhere.[2] In my view, speculative concerns about possible future anti-competitive conduct towards video programmers would have to be profound to justify structural limitations that could threaten the development of large-scale facilities-based competition in telephony and other markets. These pro-competitive benefits are not at all speculative, as demonstrated by the anticipatory competitive responses to the mere announcement of AT&T's cable-based strategy. As always, reasoned analysis of proposed regulation must consider both expected competitive benefits and expected competitive harms.

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[2] *See* Declaration of Janusz A. Ordover and Robert D. Willig (Appendix A to Reply Comments of AT&T Corp. and MediaOne Group, Inc., CS Docket No. 99-251 (filed September 17, 1999)).

Finally, in this regard, I note that: (1) the Commission has existing prophylactic rules (such as the channel occupancy rules) that directly address the core discrimination and pricing concerns at which ownership caps are targeted, and (2) the antitrust laws are specifically designed to address monopsony and foreclosure concerns on the relevant facts of particular conduct or a particular transaction in ways that an across-the-board cap could never effectively duplicate. While I do not mean to suggest that either regulation or antitrust laws are perfect in deterring anticompetitive behavior, they certainly have relevance to the determination of the proper ownership limit.

Even with the restrictive assumptions noted above, Opponents have, in my view, failed to demonstrate the existence of real, nonconjectural monopsony, foreclosure or diversity concerns sufficient to justify the inflexible structural limitation of an ownership cap anywhere near 30 percent. And because inflexible across-the-board structural prohibitions can preclude pro-competitive activity, the burden should be on those advocating an inflexible ownership limit to demonstrate that the competitive concerns the limit purports to address are both real and substantial. Indeed, numerical "caps" should be regarded more as safe harbors and not limits that cannot be lifted.

Monopsony Power. Basic economic theory teaches that an MSO could drive fees paid to sellers of programming ("Programmers") below competitive market levels only if: (1) the MSO could credibly threaten not to carry a Programmer's product unless the MSO's demands were met, and (2) the Programmer would not be able to offer quality programming without carriage by that MSO. Neither condition is likely to be met in today's competitive MVPD environment.

As an initial matter, video programming is a *nonexclusive* input – *i.e.*, selling video programming to one buyer does not preclude selling it to other buyers. And the marginal cost of selling the same programming to an additional buyer, regardless of buyer size, is likely to be quite low. In these circumstances, the correlation between buyer size and buyer power is far from clear.

But even if traditional monopsony analysis were appropriate here, there could be no monopsony concern. Even a large MSO could not credibly threaten to refuse to carry programming that customers value, given the presence of DBS competitors that today have the ability to serve all MVPD subscribers,[3] and that are, in fact, already winning two out of every three new subscribers.[4] Customers have demonstrated a willingness to switch, and a decrease in the quality of an MSO's service would simply drive more actual and potential cable customers to

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[3] I am aware of no significant limit to the capacity of DBS providers to expand the number of customers they serve. DBS providers can expand output almost instantaneously because they already have invested in 100 percent national coverage, and, given that most costs are fixed, the marginal cost of serving additional subscribers is very low. It is true that some households may be unable to subscribe to a DBS service because of line-of-sight requirements in placing the receiving satellite antenna. However, this has no relevance for assessing a cable operator's monopsony power because even if an MSO could somehow identify customers that cannot receive DBS, the MSO could not deny quality programming to only those consumers that cannot switch to DBS. In this regard, I understand that both the Cable Act, 47 U.S.C. §§ 543(d) and (e), and many local franchise agreements and regulations require cable operators to have a rate structure for the provision of most cable services that is uniform throughout the geographic area in which cable service is provided. Consequently, a cable operator cannot escape the competitive constraints imposed by DBS by employing a strategy that segments its subscriber base.

[4] *See* Fifth Annual Report, *Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming*, CS Docket No. 98-102, ¶ 62 (Dec. 23, 1998) ("*Fifth Annual Video Competition Report*"). Although DBS has several significant advantages over cable systems (including more channels and not being subject to "must carry" requirements), I am aware that DBS does presently suffer from one drawback compared to cable systems – DBS cannot provide local broadcast TV. I am told that Congress is likely to end this artificial limitation soon. Even now, of course, the local signal limitation does not prevent DBS from competing with cable – as confirmed by the rapid growth of DBS relative to cable. In this regard, I note that local signals are available on low-subscription-rate "basic" cable, and consumers can thus substitute DBS for the upper tier portions of cable service to which the various monopsony and foreclosure theories are generally directed.

DBS and other competitors.[5] Once driven to DBS, subscribers are extremely difficult to regain because DBS locks in its customers with long term contracts in exchange for "free" or highly discounted satellite dishes. Moreover, a video customer lost to a facilities-based competitor may well mean lost opportunities to provide telephony, Internet and other services to that customer. That may be one reason why we observe a "race to the top" in the MVPD marketplace, with all MVPDs investing heavily to *increase* the number of channels and services they offer customers.[6] Programmers undoubtedly are aware of these facts, and it is therefore difficult to imagine circumstances in which a Programmer would find a threatened refusal to carry credible.[7]

This is a reflection of the general principle, widely recognized in economics, that the existence of substantial excess capacity, demonstrated cross-elasticity and low switching costs

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[5] *See* Complaint, *United States of America v. Primestar, Inc. et al.*, ¶ 63 (D.D.C. May 12, 1998) ("most DBS subscribers in recent years are former cable subscribers who either stopped buying cable or downgraded their cable service . . . . Cable and DBS compete by offering similar packages of basic and premium channels for a monthly subscription fee.").

[6] Although DBS is currently the largest cable competitor, C-Band, wireless cable systems and SMATV providers currently provide MVPD services to nearly 4.5 million subscribers. *See* The Kagan Media Index, p. 8 (Aug. 18, 1999). Moreover, U S WEST has begun using DSL technology to deliver video service over its existing, ubiquitous network, *Fifth Annual Video Competition Report* ¶ 114, and it is my understanding that other incumbent LECs are following U S WEST's lead. Similarly, electric utilities such as PEPCO (in a joint venture with RCN) have begun to aggressively market video services. *Id.* ¶ 12. Even where these and other technologies are just emerging, they are relevant to the proper ownership limit under well-established antitrust analysis that employs a two year time frame to assess the impact of new entry on the ability of an entity to exercise market power.

[7] I note that this analysis applies equally to the "launch" of new programming. A large MSO's incentive to launch new programming is no less than a small MSO's incentive to launch such programming – in either case, the incentive to add good programming is spurred by the threat of facilities-based competition. In fact, a large MSO may be *more* willing to take on the risks associated with allocating limited capacity to unproven programming. It is also important to recognize that a new network that has not yet sunk substantial costs has, in that sense at least, a bargaining advantage as compared to more established networks.

make static "market" share figures very poor measures of buying or selling power. This principle should be familiar to the Commission. For example, the Commission applied it and did the economically rational thing in finding AT&T "non-dominant" – *i.e.*, unable to exercise market power – in the domestic long distance market when AT&T had significantly more than half of all customers.[8] As the Commission recognized there, the ability of other long distance providers to serve the demand and the ability and willingness of consumers to switch carriers rendered static market shares meaningless.

In any event, it is plain that a Programmer could compete effectively without carriage by an MSO that currently served 45 percent (or even more) of subscribers (but would, of course, soon serve fewer customers if the programming in question was valued by customers). Even under a static analysis, MVPD providers that serve over 45 million subscribers would remain available.[9] The highest estimates of minimum viable scale for network program of which I am aware are 15 to 20 million subscribers,[10] and I understand that many Programmers operate profitably and continue to produce new quality programming with many fewer subscribers.

Further, the proponents of low ownership caps ignore fundamental principles of market definition. The importance of any one buyer (*i.e.*, the willingness of a seller to accept below-

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[8] Order, *Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier*, 11 FCC Rcd. 3271 (1995).

[9] An MSO at a 45 percent limit would serve approximately 37 million of the 82 million current MVPD subscribers, leaving approximately 45 million subscribers served by other MVPDs.

[10] *See* Memorandum Opinion and Order on Reconsideration and Further Notice of Proposed Rulemaking, *Implementation of Section 11(c) of the Cable Television Consumer Protection and Competition Act of 1992*, MM Docket No. 92-264, & 44 (June 26, 1998) (new national, advertiser-supported network requires a "threshold subscriber base of ten to twenty million subscribers").

market terms) is a function of that buyer's size relative to all other potential buyers – regardless of whether the products produced by those alternative buyers compete directly with the products of the buyer in question. It cannot be doubted that, even aside from MVPD buyers serving the 45 million or more subscribers not served by a hypothetical "45 percent" buyer, for example, there are many other outlets for quality video programming, including video cassettes, broadcast TV networks, first-run syndication, and foreign cable companies (especially those in neighboring Canada and other English speaking countries). Thus, even under a static analysis, the "45 percent" of subscribers "controlled" by such an MSO would translate into a much lower share of relevant purchasers.

Nor can Opponents reasonably rely on any concerted action theory to bolster their arguments that MSOs will jointly exercise monopsony power. Express "bid-rigging" or collusion is, of course, subject to civil and criminal antitrust penalties that are generally thought to be adequate preventive measures. Thus, concerted action claims generally proceed from a "tacit" collusion premise – *i.e.*, that concerted action will be accomplished through the coordinated actions of market participants. For example, a price leader may signal its "cartel" followers what prices to pay and/or which programming to carry. Here, any such arrangement would face a number of obvious and formidable obstacles.

Video programming contracts are private, long-term contracts for which prices are not published and therefore, unlike in other contexts, a favorable contract obtained by one MSO does not benefit any other MSOs. It is thus difficult to see how a "tacit joint bargaining cartel" could function at all in this context. Moreover, I understand that contract terms tend to be staggered with different MSOs unlikely to be on the same contract cycle. Absent overt bid-rigging, there is no obvious signaling mechanism. In addition, any collusion presumably could be detected by a video Programmer marketing its programming to all MSOs because the collusion would require the MSOs all to demand very similar contract terms. And there is no simple mechanism for the tacit cartel to effectively punish the MSO who, for whatever reason, deviates from the monopsonistic arrangement. In sum, even if MSOs could figure out how to form a tacit joint bargaining cartel, tacit monopsonistic collusion is highly unlikely because detection of cheating and punishment of the cheater is extremely difficult.

In all events, even if theoretically possible, there is no "safety in numbers" here that would overcome the central reason why a single large MSO could not credibly threaten to drop programming that customers desire. As described above, DBS and other competitors are waiting in the wings and willing and able at little cost to serve all cable customers. With this all too real competitive threat hanging over the "cartel's" collective head, it is difficult to imagine a group of cable MSOs agreeing not only that demanding anticompetitively low prices from video Programmers is in their individual interests but also how far to push given the risk of losing customers to competing providers. In short, even if cable ownership were highly concentrated, coordinated monopsony power would not likely be successful or long-lived.[11]

Foreclosure. A successful foreclosure strategy would require a vertically integrated MSO to: (1) materially raise rival Programmers' costs; and (2) take advantage of the rivals' higher

[11] Moreover, others have demonstrated that if monopsony power did exist, each cable system would be a monopsonist only with respect to programming supplied to its franchise area, and that combining franchise areas, if anything, helps internalize the effects of monopsony, resulting in less incentive to restrict quantity purchased. *See* Robert Crandall, "Economic Analysis of Market Structure in the Cable Television Business" at 10-11 (submitted by NCTA in FCC NOI Docket No. MM 89-600).

costs by raising the price of affiliated programming that the MSO sells to other MVPDs.[12] For many of the same reasons discussed above, and others discussed below, the foreclosure claims raised by proponents of a low ownership cap are insubstantial even as applied to an MSO that currently serves 45 percent or more of MVPD subscribers.[13]

Again, the ability of DBS providers to quickly and easily serve MVPD customers throughout the United States is the obvious answer to such concerns. If an MSO refused to carry a program that subscribers valued, they could simply go to DBS (or, for an increasing number of subscribers, to one of the many other existing and emerging facilities-based alternatives discussed above). In this regard, a cable MSO with 45 percent of current MVPD subscribers, for example, would leave over 45 million subscribers available to a disfavored Programmer on "day 1" of the anticompetitive strategy. As noted above, that is more than enough for viability under any estimates I have seen. But, as also noted above, such static analysis greatly understates the scope of the video Programmer's alternative outlets. A dynamic analysis that properly considered the excess capacity of DBS and other substitutes that are likely to emerge within the next two years

[12] As explained above, the existence of many successful Programmers with 15 million or fewer subscribers is strong evidence that a hypothetical "45 percent" MSO would have no ability to drive rival Programmers out of business altogether.

[13] I deal here with foreclosure attempts by a single MSO. The notion of "coordinated" foreclosure – *i.e.*, that unaffiliated MVPDs would collude to disadvantage Programmers – makes little economic sense. MVPDs that are unaffiliated with a particular video Programmer have no incentive to foreclose rivals to that Programmer. All that would accomplish is to make the unaffiliated MVPD's service less attractive. Moreover, these unaffiliated MVPDs would be among the "targets" of the foreclosure strategy – the principal reason to weaken the rival Programmer is to be able to raise the prices the affiliated Programmer charges to other MVPDs. I also make the conservative assumption that cable MSOs have full ownership and control of the affiliated video Programmer. Where even a large MSO has limited financial interests in a Programmer, it has lesser – if any – incentives to foreclose.

would properly recognize that even the approximately 37 million subscribers of the hypothetical "forecloser" would continue to be up for grabs.

Foreclosure claims also ignore the formidable counter-strategies available to disfavored Programmers. Most Programmers are large multi-national firms that own several different programming networks.[14] Even if an MSO were relatively indifferent whether it carried some of these networks, most of these Programmers hold exclusive rights to one or more very popular networks that, if not carried, would place an MSO at a significant competitive disadvantage with DBS. An MSO's threat to drop one of these Programmers' "second tier" networks could thus be met with a threat by the Programmer to retaliate by denying the MSO carriage of its entire package of programming, including the Programmer's most popular networks. In fact, I understand that it is quite common for Programmers to use "bundling" in this fashion to gain "bargaining power" as well as to lessen the competitive pressures on their "weaker" offerings that face more ready substitutes.

I also understand that Programmers have consistently demanded and received steep price increases for virtually all programming even as industry consolidation produces ever larger buyers.[15] This is compelling evidence that in programming negotiations the balance of power has not shifted towards buyers. Nor does it appear that there has been any reduction in the quality of cable programming. For example, I understand that this year alone, a record number of cable networks (19) have garnered a total of 134 Emmy nominations.[16]

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[14] *See generally Fifth Annual Video Report*, Table D-1.

[15] *Id.* ¶ 24.

[16] NCTA Press Release, *Record Number of Cable Networks Garner Primetime Emmy Nominations* (July 22, 1999) (<www.ncta.com>).

Relatedly, many of the Programmers that might be targets of a foreclosure strategy are themselves affiliated with other MSOs.[17] If the hypothetical 45 percent MSO tried to foreclose a Programmer affiliated with another MSO, the second MSO could in turn retaliate and refuse to carry the affiliated programming of the foreclosing MSO. In this context, the MSO contemplating foreclosure could find its affiliated programming subject to an equal or greater amount of foreclosure.

For these reasons, foreclosure likely will be a very costly undertaking. By foreclosing access to rival programming that subscribers want, an MSO reduces the value of its offering and that will inevitably result in lost revenues. Moreover, the MSO risks retaliation by both Programmers and other MSOs that could further multiply the costs of the strategy. And, where the "affiliated" Programmer is only partially owned but not controlled by the MSO, the MSO might well find itself a victim of any price increases facilitated by the foreclosure. In these cases, the foreclosing MSO bears all of the cost of foreclosure but shares the benefits with the other owners of the advantaged Programmer. Thus, like any exclusionary strategy, for a foreclosure strategy to work, the MSO must be able, over a sustained period, to raise the prices its Programmer affiliate charges (or to sell much more of the programming than it otherwise would have sold) so that it makes up foregone revenues.

But the ability to recoup the revenues lost by foreclosure is highly unlikely. Despite the fact that video programming entails significant sunk and fixed costs leading to scale economies, entry has been occurring at a rapid pace. This strongly suggests that entry impediments are low relative to the seemingly insatiable demand for new content. For example, in the last two years

[17] *See Fifth Annual Video Competition Report*, Appendix D.

alone, the number of new services offered totaled 98.[18] The Commission has also identified 65 planned national programming services that are expected to launch soon.[19]

Competitively disadvantaging a Programmer does no good if another Programmer can easily enter and fill its shoes.[20] This is particularly true as the assets used by the prior Programmer would be available to a new entrant. For example, if an MVPD disabled "Bravo" in order to advance its own "highbrow" movie channel, the movies shown by Bravo could still be purchased and shown by a new entrant (or could be purchased directly by another MVPD).

In addition, it will often be the case that inducing exit or lessening the competitive strength of just one rival will not be enough. In order to be able to raise prices (or sell more), an MSO may need to foreclose many, if not all, of the Programmers that compete with its affiliate. Given that there are currently over 245 national satellite-delivered video services, this could require the successful foreclosure of numerous Programmers. Again, given the strength of many of these video Programmers (and their ability to use bundling), this seems highly unlikely.[21]

Diversity of Viewpoints. I am not opining on whether preserving a diversity of viewpoints is a legitimate goal. Assuming that it is, the question that must be addressed is whether imposing a structural limitation on horizontal ownership of cable systems is an efficient

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[18] *Id.* ¶ 159.

[19] *Id.* ¶ 168.

[20] This entry could either occur *de novo* or by another Programmer already in the market.

[21] In this regard, I note that the empirical studies of which I am aware do not support claims that large MSOs have discriminated in favor of affiliated programming. *See, e.g.*, Besen, Moresi & Woodbury, *An Economic Analysis of the Effects of the AT&T-MediaOne Merger On Competition In the Supply and Distribution of Video Programming Services*, at 42-45 (Appendix G to Reply Comments of AT&T Corp. and MediaOne Group, Inc., CS Docket No. 99-251 (filed September 17, 1999)).

means to accomplish this. I believe, however, it is not. First, imposing such a limitation could deny consumers substantial economic benefits from breaking the incumbent LECs' stranglehold on local telephony and by slowing down the widespread introduction of broadband Internet access and other innovative services.

Second, once concern about the size of MSOs is untethered from the economic rationales of monopsony and vertical foreclosure, there is no obvious link between size and the diversity of information sources available to any MSO's customers. Customers buy programming locally. Whether the owner of the cable systems in Washington also owns the cable systems in New York has no impact whatsoever on the diversity of information sources available to viewers in either Washington or New York.

Third, viewers in every area have access to whatever information the MSO in their area provides, in addition to the information supplied via satellite, broadcast TV, Internet, and the myriad other ways information and viewpoints are communicated.[22] There is nothing special about the "information" provided by MSOs, and the "amount" of information carried by MSOs is relatively small compared to all the ways in which households receive ideas. Hence, from the standpoint of assessing "market power" over the flow of ideas, information delivered via cable is not likely to be the relevant market. In the "market for ideas and information" cable is but a small player.

Fourth, in contrast to a broadcaster who must program each time slot on his channel for a 24-hour day, the MSO is not programming specific time slots but merely selecting programming

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[22] *See, e.g.*, Bruce M. Owen & Steven S. Wildman, *Video Economics* 236 (1992) ("cable MSOs are not the only gatekeepers" of information).

providers who each decide how to fill their allotted channels. Finally, the MSO's increasing incentive – because of competition from DBS, VCRs, DVDs, and the Internet, among others – is to offer a great abundance and diversity of programming. The traditional analogy in this context of a single-screen movie house that tries to show only movies that embody "family values" simply does not carry over to a "multiplex" that has 60 or more screens to fill and lots of competition.

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In sum, monopsony, foreclosure and diversity claims that underlie the proposals for continued tight horizontal caps are highly conjectural and appear contrary to the evidence that exists. For example, the rates that cable MSOs pay video Programmers continue to rise at rates well above the rate of inflation. At the same time, I understand that the number and variety of video programming services continues to increase rapidly even as cable consolidation continues. The video programming industry hardly shows signs of weakness that warrant government intervention. In these circumstances, it is my view that neither video Programmers nor, more importantly, the public should be concerned that relaxing the cap to 45 percent of MVPD subscribers or even more would likely lead to anticompetitive results. Indeed, the shares of subscribers going to DBS and other alternatives to cable is highly expandable. Consequently, attempts by AT&T to exercise monopsony or foreclosure power would be rendered unprofitable by customer desertion. At the same time, structural limitations that could impede broader pro-competitive efforts by cable companies pose a serious threat to the public interest.

Regardless what horizontal limit the Commission ultimately adopts, however, it should make clear that the limit merely establishes a safe harbor and not an inflexible ceiling. Generic ownership limits and attribution rules are, by their nature, incapable of reflecting all of the specific economic factors that determine whether allowing a particular MSO to grow above those limits will, on balance, be good or bad for consumers. And two of the factors identified above – (1) the substantial pro-competitive benefits of allowing cable companies to compete effectively with incumbent LECs, and (2) the danger that generic attribution rules will improperly attribute to an MSO subscribers as to which the MSO has no programming involvement – strongly counsel in favor of regulatory flexibility on such issues.[23]

[23] For all of the reasons stated above, a limit much higher than the 35 percent "safe harbor" used by Department of Justice in its Merger Guidelines and in its business review letters is appropriate here. I closely participated in drafting the Merger Guidelines, and the key factor animating the 35 percent factor was the recognition that it would apply generically to all industries, including static industries without excess capacity. A lower figure to address such worst-case scenarios was deemed appropriate, only because the figure is merely a safe harbor below which competitive concerns are very unlikely and even above which challenge will not be necessary when market considerations constrain the possibility of anticompetitive effects.

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