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BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

In the Matter of	)	
	)	
Annual Assessment of the Status of	)	CS Docket No. 00-132
Competition in Markets for the	)	
Delivery of Video Programming	)	

COMMENTS OF AT&T CORP.

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TABLE OF CONTENTS

PAGE NO.

I. INTRODUCTION AND SUMMARY 1

II. CONTRARY TO THE SUGGESTIONS IN THE NOI, CLUSTERING *DOES* PROVIDE SIGNIFICANT BENEFITS TO CONSUMERS BUT *DOES NOT* CAUSE HIGHER CABLE PRICES 6

A. The Data that AT&T Recently Submitted as Part of This Year's Cable Price Survey Confirm that Clustering Facilitates the Provision of Advanced Services Such as Local Telephony and High-Speed Internet Access. 7

B. There Are Flaws in the *1999 Price Report's* Methodology For Analyzing The Effect Of Clustering on Cable Prices, and the Data and Analyses Submitted Herein By AT&T Disprove the Suggestion that There Is a Link Between Clustering and Higher Cable Prices. 13

III. THE PACKAGING OF VIDEO AND NON-VIDEO SERVICES HAS BECOME AN IMPORTANT CHARACTERISTIC OF THE COMMUNICATIONS MARKETPLACE AND IS PRODUCING SIGNIFICANT CONSUMER BENEFITS IN TERMS OF INCREASED CHOICE AND LOWER PRICES 17

A. AT&T's Offering of Packaged Services Is Fostering Competition in Local Phone Markets. 17

B. Packaging of Services Has Become Commonplace in the Communications Industry 19

IV. THE COMMISSION'S RECENT CHANGES TO THE CABLE OWNERSHIP RULES DO NOT GO FAR ENOUGH TO REFLECT THE CURRENT STATE OF THE VIDEO MARKETPLACE, AND IN CERTAIN KEY WAYS CONTINUE TO PRODUCE HARMFUL AND ARBITRARY RESULTS 23

A. Revised Cable Ownership Rules. 23

B. Revised Cable Attribution Rules 26

V. CONCLUSION 31

APPENDIX A FCC Regression Analysis Using AT&T 2000 Survey Data

APPENDIX B FCC Regression Analysis Using 1999 MSO Survey Data But Weighting System Prices By Number of Subscribers

APPENDIX C FCC Regression Analysis Using AT&T 2000 Survey Data But Modified to Include Four New Variables

APPENDIX D FCC Regression Analysis Using MSO 1999 Survey Data But Modified to Include Four New Variables

Declarations of Jennifer Fess & Rodger A. Woock, Members of AT&T Labs - Broadband

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COMMENTS OF AT&T CORP.

AT&T Corp. ("AT&T"), by its attorneys, hereby files its comments in response to the Commission's Notice of Inquiry ("*NOI*") in the above-captioned proceeding.[1]

I. INTRODUCTION AND SUMMARY

Competition in the MVPD marketplace is thriving. Non-cable MVPDs now serve more than 20% of all multichannel video subscribers nationwide,[2] well beyond the 15% penetration threshold for "effective competition" in local franchise areas.[3] DirecTV and EchoStar alone have achieved a combined 15.8% national share of all MVPD subscribers[4] and rank today as the

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1 *In the Matter of Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming*, Notice of Inquiry, CS Docket No. 00-132, FCC 00-270 (rel. Aug. 1, 2000) ("*NOI*").

2 According to recent statistics in *The Kagan Media Index*, there are 17 million non-cable subscribers (or 20% of the 84.9 million MVPD subscribers), including: 13.4 million DBS subscribers, 1.3 million backyard dish subscribers, 1.5 million SMATV subscribers, and 0.8 million wireless cable subscribers. *See The Kagan Media Index*, July 31, 2000, at 8.

3 *See* 47 U.S.C. §543(l)(1)(B) (defining "effective competition").

4 *See The Kagan Media Index*, July 31, 2000, at 8.

third and sixth largest MVPDs, respectively.[5] Moreover, DBS is growing 20 times as fast as cable, obtaining exclusivity rights to valuable sports and entertainment programming, partnering with powerful ILECs to market programming locally, and aggressively entering the Internet access business.[6] The ability of DBS providers to carry local broadcast signals pursuant to the recently-enacted Satellite Home Viewer Improvement Act[7] has further strengthened their competitiveness.[8] EchoStar, for example, has stated that its offering of local broadcast channels has led to a 20% increase in new subscriber growth,[9] and a recent study conducted by the satellite industry found that the availability of local broadcast channels contributed significantly to new subscriber growth for DBS in the first quarter of this year.[10]

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[5] DirecTV currently serves over 8.7 million subscribers, including former PrimeStar customers. *See DirecTV To Offer Local Channels In Seven Additional Markets*, DirecTV Press Release (Aug. 15, 2000). EchoStar has over 4.3 million customers. *See EchoStar Signs P.C. Richard & Son As New Regional DISH Network Retailer*, EchoStar Press Release (Aug. 16, 2000).

[6] *See In the Matter of Annual Assessment of the Status of Competition in the Markets for the Delivery of Video Programming*, Sixth Annual Report, CS Docket No. 99-230, 15 FCC Rcd. 978, at ¶¶ 20, 70 (1999) (comparing cable's 1.8% subscriber growth rate to the 39% growth rate for DBS); ¶ 72 (noting exclusive sports packages); ¶ 145 & n. 298 (referencing DirecTV's marketing agreement with SBC and other LECs); ¶ 81 (noting DBS offerings of data and interactive services) ("*1999 Video Competition Report*").

[7] Pub. L. No. 106-113, § 1000(9), 113 Stat. 1501 (1999) (enacting S. 1948, including the Satellite Home Viewer Improvement Act of 1999).

[8] DirecTV, for example, will by late October be offering local broadcast packages in 37 markets, representing about 60% of TV households. *See* Monica Hogan, *DBS Keeps Punching in Cable Markets*, Multichannel News, Aug. 21, 2000, at 14.

[9] *See* Christopher Stern, *Satellite, Cable Firms Escalate Competition*, The Washington Post, Aug. 13, 2000, at E1 (also noting that 50-60% of new subscribers to DirecTV and EchoStar sign up for local channels).

[10] *See New Study Shows Satellite TV Growth Coming At The Expense Of Cable*, Press Release of Satellite Broadcasting & Communications Association ("SBCA") (June 28, 2000) (noting results of study conducted jointly by SBCA and The Yankee Group).

It is no wonder, therefore, that the Justice Department has found that consumers view DBS and cable as substitutable services.[11] This conclusion is further underscored by the fact that more than half of DBS subscribers are former cable customers.[12] As DirecTV President Eddy Hartenstein has stated, "We have dramatically and permanently changed the TV landscape as consumers continue to switch away from cable in record numbers."[13] DBS is no longer "sneaking up" on cable. Rather, it is a powerful presence in the marketplace *today,* engaging in a fierce battle with cable for every subscriber.[14]

In addition, none of the characteristics that antitrust scholars look to as evidence of market power or lack of competition -- supracompetitive prices, restrictions on output, and a lack of innovation -- is present in the cable industry. To the contrary, cable price increases have been

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[11] *See* Complaint, *United States v. PRIMESTAR, Inc.*, No. 1:98CV01193, ¶ 63 (D.D.C. 1998) (concluding that "[w]hile the [cable and DBS] programming services are delivered via different technologies, consumers view the services as similar and to a large degree substitutable.") ("Primestar Complaint").

[12] In fact, DirecTV states that 70% of its new customers come from cable operators. *See Pay-TV War Between DBS And Cable Heats Up*, Comm. Daily, Aug. 23, 2000, at 1-2. *See also* Primestar Complaint at ¶ 63 ("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"); Stern, *supra* n. 9.

[13] *See* CableFAX Daily, November 16, 1998, at 2.

[14] *See Pay-TV War Between DBS And Cable Heats Up*, *supra* n. 12 (noting that "DBS and cable industries are turning up pressure on each other to produce 'better, more efficient service' to keep up in 'maddening race' for rapidly growing revenue streams," and quoting industry source as saying: "There is a sense of urgency to compete and roll out new services in the marketplace that we haven't seen in a long time."). *See also* Monica Hogan, *MSO Buybacks Test Dish Loyalty*, Multichannel News, July 31, 2000, at 1 (noting that cable operators are responding to DBS competition by offering digital programming credits and free digital cable installation to DBS customers who turn in their dishes and receivers and commit to one-year of digital cable service).

reasonable and consistent with the rising costs of the quality programming operators deliver;[15] per-channel prices have not changed despite significant increases in programming costs;[16] and cable output (in terms of additional channel capacity) and innovation have been growing dramatically.[17] Even beyond the fact that cable's competitors now have over a 20% market share and are capturing two of every three new subscribers,[18] such competition is forcing cable operators to accelerate investment in plant upgrades, increase innovation in new technologies, create more diverse programming services, and offer creative new price and packaging options.

In short, the MVPD marketplace is now unmistakably competitive and cable operators are today acting and investing precisely as one would expect companies subject to competition to

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[15] The Commission reported that license fees paid by cable operators to basic cable network programmers increased 14.6% in 1999, and are projected to increase by an additional 10.9% in 2000. *See 1999 Video Competition Report* at ¶ 26. Cable rate increases, in contrast, have slowed in recent years. *See In the Matter of Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992: Statistical Report on Average Rates for Basic Service, Cable Programming Services, and Equipment*, Report on Cable Industry Prices, MM Docket No. 92-266, FCC 00-214, at ¶ 4 (rel. June 15, 2000) ("*1999 Price Report*").

[16] *See 1999 Price Report* at ¶ 8. Significantly, cable operators have managed to keep prices competitive with other video providers despite the fact that cable operators are subject to public interest obligations that most other video providers do not share, such as PEG access channels and support, institutional networks, universal service, franchise fees, and other taxes that make it more costly for cable operators than for MMDS, SMATV, or DBS providers to deliver a comparable package of service.

[17] For example, AT&T has spent over $2.7 billion over the last two years upgrading its cable facilities to a two-way, high-bandwidth plant. Moreover, on a combined basis, AT&T and MediaOne spent approximately $400 million on capital expense upgrades in the second quarter of this year alone. AT&T projects that 75-80% of its cable plant will be two-way by the end of this year. *See also 1999 Video Competition Report* at ¶¶ 21-23 (noting industry-wide increases in channel capacity), ¶¶ 51-68 (describing provision of advanced broadband services, including digital video, cable modem service, and cable telephony).

[18] *See In the Matter of Annual Assessment of the Status of Competition in the Markets for the Delivery of Video Programming*, Fifth Annual Report, 13 FCC Rcd. 24284, at ¶ 12 (1998) ("*1998 Video Competition Report*").

act. Each of these dynamics -- a competitive marketplace and strong private sector investment -- should lead the Commission to relax or eliminate existing cable regulations (because they are no longer necessary) and to avoid adopting new regulations (because they would reduce incentives for continued investment and therefore deny consumers the benefits of such investment). In order to justify continuing regulation of the cable industry today, the Commission must find compelling evidence that cable is causing anti-competitive harm in the marketplace. AT&T submits that no such evidence exists.

The comments that NCTA will submit in this proceeding will further expound on the strong and irreversible competition in the MVPD marketplace, and AT&T concurs in NCTA's analysis. AT&T focuses its comments below on the following three issues raised in the *NOI* and supplies specific data and information to assist the Commission in drawing conclusions in these areas:

- ***Clustering***. AT&T recently submitted to the Commission empirical data in response to the *2000 Price Survey*, which, as shown below, prove that clustering provides substantial consumer benefits, including accelerated provision of local telephony and high-speed Internet access, greater channel capacity, and increased offering of digital video services. Moreover, there are flaws in the *1999 Price Report's* methodology for analyzing the effect of clustering on cable prices, and the data and econometric analyses submitted herein by AT&T disprove the Commission's suggestion that there is a link between clustering and higher cable prices. In fact, by focusing on a system's *cable* prices, the Commission's analysis fails to consider that clustering -- by facilitating the offering and packaging of multiple video and non-video services -- will yield lower *overall* prices (in addition to greater choice) for American consumers.

- ***Packaging of Video and Non-Video Services***. The packaging of video and non-video services is becoming a dominant characteristic of the communications marketplace. Consumers have indicated a strong demand for such packaged services, and AT&T has been a pioneer, first with its "One Rate" plans and now with the packaging of broadband services, in meeting that demand. Packaging of services has increased consumer choice and reduced consumer prices. The Commission should continue to refrain from restricting such service packaging.

- ***Cable Ownership and Attribution***. The Commission's recent revisions to its cable ownership and attribution rules do not fully accommodate the level of competition in the video marketplace. As a result, both the revised cable ownership and attribution rules remain overly restrictive and continue to produce harmful and arbitrary results. For example, the revised attribution rules discourage companies from pursuing LP and LLC interests, a result that is at odds with state and federal tax and other laws that *promote* the use of such corporate structures. It is incongruous for sister agencies to have such inconsistent approaches to this issue, particularly when the end result could be reduced investment and business development.

II. CONTRARY TO THE SUGGESTIONS IN THE NOI, CLUSTERING *DOES* PROVIDE SIGNIFICANT BENEFITS TO CONSUMERS BUT *DOES NOT* CAUSE HIGHER CABLE PRICES.

The NOI invites comment on the effects of clustering of cable systems on consumer prices and the rollout of advanced services, including cable telephony and cable modem service.[19] The NOI questions the benefits of clustering, noting that the *1999 Price Report* found that clustered systems had higher average prices and that fewer clustered systems offered advanced services than non-clustered systems.[20] As AT&T demonstrates below, however, clustering *does* provide substantial consumer benefits, including the accelerated rollout of local telephony and high-speed Internet access. Moreover, there are flaws in the *1999 Price Report's* analysis of the effect of clustering on cable pricing. AT&T supplies empirical data below which show that clustering *does not* cause higher cable prices.

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[19] *See* NOI at ¶ 16.

[20] *See id.* The aforementioned findings were included in the Commission's annual report on cable industry prices. *See 1999 Price Report* at ¶¶ 36-39.

A. The Data that AT&T Recently Submitted as Part of This Year's Cable Price Survey Confirm that Clustering Facilitates the Provision of Advanced Services Such as Local Telephony and High-Speed Internet Access.

In this section and the next section, AT&T analyzes the effects of clustering based on the data contained in: (1) AT&T's responses to the Commission's 2000 price survey ("AT&T 2000 Survey Data");[21] and (2) the responses of all MSOs to the Commission's 1999 price survey ("MSO 1999 Survey Data"), *i.e.*, the same database on which the Commission based its findings in the *1999 Price Report*.

As an initial matter, the conclusions of the *1999 Price Report* are flatly contradicted by AT&T's 2000 Survey Data. For example, as the chart below illustrates, a greater number and percentage of AT&T's clustered systems provide local telephony (and to more AT&T subscribers) than its non-clustered systems:[22]

	Clustered Systems in 2000 AT&T Survey Data	Non-Clustered Systems in 2000 AT&T Survey Data
Number of Systems Offering Local Telephony Service	8	0
Percentage of Systems Offering Local Telephony Service	12.7%	0%
Total Subscribers to Local Telephony Service	34,160	0
Average Subscribers Per System to Local Telephony Service	542.2	0

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21 *See* Response of AT&T, *In the Matter of Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992: Statistical Report on Average Rates for Basic Service, Cable Programming Services and Equipment*, Order, MM Docket No. 92-266, DA 00-1484 (Aug. 15, 2000).

22 A total of 137 AT&T systems were analyzed in the 2000 AT&T Survey Data. 63 of these systems were in clusters; 74 were not in clusters.

Clustering is essential to the efforts of AT&T and other cable operators to compete effectively with LECs and electric utilities because it substantially reduces the cost of providing local telephony.[23] In this regard, AT&T stresses that only four RBOCs remain -- SBC, Verizon, BellSouth, Qwest -- each of which has ubiquitous market coverage across vast geographically concentrated areas.[24] For example, AT&T uses phone switches that generally serve 120,000 to 150,000 lines. But for clustering, AT&T would be unable to deliver the subscriber base necessary to obtain maximum utilization out of the switches. Likewise, clustering creates efficiencies in negotiating network interconnection agreements with incumbent LECs, as well as interconnection and various service agreements with SS7 providers and other third-party vendors, and providing end-to-end customer service support. And this is not just theory. These cluster-driven efficiencies are at work in the marketplace to increase AT&T's local telephony competition with ILECs. Currently, AT&T has over 300,000 cable telephony customers -- a 1000% increase since the beginning of the year -- and has averaged 1,300 truck rolls per day (that number has now risen to 1,800 per day).[25] AT&T now offers the service to 4.2 million

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[23] *See* Comments of Tele-Communications, Inc., *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, at 50-51 (Aug. 14, 1998) ("TCI Comments"); Reply Comments of Tele-Communications, Inc., filed in MM Docket No. 92-264, at 21 (Sept. 3, 1998) ("TCI Reply Comments").

[24] Similarly, clustering is essential to allow cable operators to compete with DBS which effectively serves a single *national* cluster.

[25] *See AT&T Broadband Exceeds 300,000 Local Phone Customers*, AT&T Press Release (Sept. 6, 2000) (noting that AT&T added more than 40,000 customers in August); *Second Quarter Reported Earnings Were $0.53 Per Share; Operational Earnings Were $0.57 Per* Share, AT&T Group Earnings Commentary, at 12 (July 25, 2000) ("*AT&T Earnings Report*"). *See also* Mike Farrell, *AT&T Pumps Up New-Service Numbers; 2nd Quarter Earnings Report*, Multichannel News, July 31, 2000, at 34.

households in 19 markets, projects by year end that it will have 500,000 to 650,000 subscribers, and plans to launch the service in six more markets next year.[26]

Similarly, the AT&T 2000 Survey Data demonstrate that clustering also plays an important role in accelerating the provision of high-speed Internet access service:

	Clustered Systems in 2000 AT&T Survey Data	Non-Clustered Systems in 2000 AT&T Survey Data
Number of Systems Offering High-Speed Internet Access Service	46	33
Percentage of Systems Offering High-Speed Internet Access Service	73.0%	44.6%
Total Subscribers to High-Speed Internet Access Service	168,677	92,765
Average Subscribers Per System to High-Speed Internet Access Service	3,123.7	1,656.5

The reason for the higher percentage of high-speed Internet access in clustered systems is that, as with local telephony, clustering has been instrumental in helping AT&T achieve operational efficiencies relative to the rollout of these Internet services.[27] For example, AT&T incurs significant costs in leasing T1 or DS3 phone lines which are used to transport Internet data from cable headend facilities to the nearest AT&T POP and onto the Internet backbone.

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[26] The 19 markets where AT&T's residential local phone service is currently available include: Atlanta (GA), the San Francisco Bay Area (CA), Boston (MA), Chicago (IL), Dallas (TX), Denver (CO), Detroit (MI), Hartford (CT), Jacksonville (FL), Los Angeles (CA), Pittsburgh (PA), Pompano Beach (FL), Portland (OR), Richmond (VA), Salt Lake City (UT), Seattle (WA), St. Louis (MO), Southern New Hampshire, and the Twin Cities (MN).

[27] AT&T also notes that the above data illustrate that while clustering has facilitated and accelerated AT&T's deployment of high-speed Internet access to its customers, AT&T also continues to aggressively deploy this service to *all* of its systems, even non-clustered systems, across the country.

Clustering enables AT&T to defray those leasing costs over a number of systems and a larger subscriber base. Similar efficiencies arise in payment for fixed equipment costs. Rather than having to buy CMTS equipment for every cable system in a cluster, for example, AT&T can purchase such equipment for a smaller number of headends that serve the entire cluster. It is also less expensive to market high-speed data -- and other advanced services -- to a cluster.

As with local telephony, these efficiencies are allowing AT&T to maintain its aggressive rollout of high-speed Internet access. For all of its systems, at the end of June 2000, AT&T had approximately 700,000 cable modem customers and was installing 1,800 subscribers per day (the installation rate has since increased to 2,000 per day).[28] AT&T is on target to exceed 1.1 million subscribers and pass 15 million households in over 25 major markets by the end of this year.

The benefits of clustering extend even beyond the facilitation of local telephony and high-speed Internet access. For example, the AT&T 2000 Survey Data demonstrate that AT&T's clustered systems provide a greater number of activated channels and a greater number of digital video services than its non-clustered systems:[29]

	Clustered Systems in 2000 AT&T Survey Data	**Non-Clustered Systems in 2000 AT&T Survey Data**
Average Active Channel Capacity	85.2	66.6
Average Number of Digital Video Services	106.2	95.1

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28 *See AT&T Earnings Report* at 12.

29 AT&T notes that it is adding digital video customers at a rate of 3,200 per day, and at the end of June had 2.2 million subscribers to its digital service, compared to 1.3 million subscribers a year ago. *See id.*.

Moreover, as AT&T has previously discussed,[30] clustering has the following additional benefits:

- ***Better Customer Service and Fewer Outages***. Clustering enables a cable operator to centralize its customer service and maintenance functions to reduce the number of call centers and better position truck fleets to offer quicker and superior service to consumers. In addition, a cable operator's operating support and network management systems can be implemented more cost effectively. This, combined with the use of consistent components and architecture, allows for more sophisticated support systems that will aid in preventing outages and restoring service more quickly to customers in the event of an outage.

- ***Delivery of a Higher Quality Signal to Consumers***. Clustering enables cable operators to better design the architecture of their physical plant. For example, combining physically adjacent cable systems may make it possible to eliminate headends. A central headend can be utilized that connects to the outlying hubs by a fiber ring. This permits improved signal quality since off-air signals can be picked up at or near the broadcast source and satellite receivers can be located to avoid terrestrial interference and signal diminution. The use of a central headend also facilitates greater uniformity in channel lineups which increases consumers' understanding of the operator's service offerings.

- ***More Local and Regional Programming for Consumers***. Local and regional programming services, such as news and sports, are often difficult for any single cable operator to develop if its systems cover only a fraction of a given metropolitan area. Efforts to develop and operate such programs with other cable operators can be cumbersome and inefficient. A cable operator's ability to spread the costs of programming over a greater number of subscribers within a region increases the prospects of success and, therefore, the likelihood that the operator will incur the cost of developing local and regional programming.

- **More Efficient Interconnections Which Enhance Educational and Government Uses**. By establishing a regional network, cable operators can provide increased interconnectivity so that local origination, government, and educational channels can be aired to one, several, or all communities in the cluster. Institutional networks could obtain the same benefit because they would interconnect with a much larger base. This is particularly important to educators who wish to use interconnections for distance learning.

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[30] *See, e.g.*, Applications and Public Interest Statement of AT&T, *In the Matter of Applications for Consent to the Transfer of Control of Licenses from MediaOne Group, Inc. to AT&T Corp.*, CS Docket No. 99-251, at 30-31 (July 7, 1999) ("Public Interest Statement"); TCI Comments at 49-53; TCI Reply Comments at 20-24.

- **More Attractive Joint Consumer Promotions and Discounts With Area Retailers and Others**. Currently, it is difficult and expensive for cable operators to advertise their own services using radio, broadcast television, and local newspapers because a substantial portion of the audiences reached by such media are not served by the operator. Clustering increases the number of potential subscribers an operator can reach with each advertising dollar. In addition, clustering makes it easier to engage in more attractive joint consumer promotions and discounts with area retailers and others (*e.g.*, McDonald's, local sports teams) because a cable operator's service area will more closely approximate the customer base of the other party.

Indeed, the Commission and other federal entities, including NTIA and GAO, have repeatedly recognized the very significant benefits of clustering to consumers and clustered cable operators.[31] In its *1999 Video Competition Report*, for example, the Commission noted that "[c]lustering of cable systems can create greater economies of scale and size," thereby enabling "cable operators to offer a wider variety of broadband services at lower prices to customers in geographic areas that are larger than single cable franchise areas."[32] The Commission concluded that clustering "can thus make cable operators more effective competitors to LECs whose local service areas are usually much larger than a single cable franchise area."[33] Similarly, NTIA has previously voiced its strong opinion that clustering is essential to the future of telecommunications and that any potential harms of clustering are "largely conjectural, speculative, or *de minimis*."[34] The data and analysis AT&T has submitted herein and in other Commission proceedings strongly confirm this conclusion.

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31 *See, e.g.*, *1999 Video Competition Report* at ¶¶ 161-165 (2000); *1998 Video Competition Report* at ¶¶ 144-148.

32 *1999 Video Competition Report* at ¶ 162.

33 *Id.*

34 See Letter from Larry Irving, Asst. Secretary of Commerce, to the Honorable Janet D. Steiger, Chairman, Federal Trade Commission, Jan. 12, 1995 at 2. *See also* United States General Accounting Office Report to Senate Judiciary Subcommittee on Antitrust, Business

(footnote continued ...)

B. There Are Flaws in the *1999 Price Report's* Methodology For Analyzing The Effect Of Clustering on Cable Prices, and the Data and Analyses Submitted Herein By AT&T Disprove the Suggestion that There Is a Link Between Clustering and Higher Cable Prices.

In its *1999 Price Report*, the Commission used a regression equation to analyze whether clustering has a "measurable effect" on monthly cable prices. The Commission found that "operators that were part of a cluster had, on average, higher monthly rates than operators that were not part of a cluster."[35] The NOI seeks comment on this conclusion.[36] As shown below, there are flaws in the *1999 Price Report's* cluster-pricing analysis which likely skewed the Commission's results, and, in fact, the data and econometric analyses submitted herein by AT&T disprove the Commission's suggestion that clustering is linked to higher cable prices.

As an initial matter, AT&T notes that its recent 2000 Survey Data (submitted to the Commission on August 15, 2000) are at odds with the Commission's pricing conclusion in the *1999 Price Report*. AT&T asked two members of AT&T Labs - Broadband, Jennifer Fess and Rodger Woock (who are experts in statistics and econometrics), to run the Commission's regression equation using the AT&T 2000 Survey Data.[37] The results of this regression analysis

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(... footnote continued)

Rights, and Competition, *Telecommunications: The Changing Status of Competition to Cable Television,* GAO/RCED-99-158, at 19-20 (July 1999) (finding that ownership ties and clustering strategies may provide cost savings and possible competitive advantages).

35 *1999 Price Report* at ¶ 39.

36 *NOI* at ¶ 16.

37 AT&T is grateful to John Scott and Kiran Duwadi of the Cable Services Bureau who provided Ms. Fess and Mr. Woock with valuable assistance during their analysis, mostly to help them understand the approach and various assumptions used by the Commission in applying the regression equation to last year's MSO survey data. Fess and Woock applied the same approach and assumptions in applying the Commission's regression equation to AT&T's 2000 Survey Data.

-- which are included in Appendix A -- disprove the Commission's claimed connection between clustering and higher cable prices.[38] Specifically, because the clustering variable is not significantly different from zero, the regression demonstrates that the substantial benefits of clustering described above are provided to consumers *without* affecting the monthly cable prices paid by AT&T customers.

Moreover, there are several shortcomings with the Commission's regression equation which likely explain the Commission's finding in the *1999 Price Report* regarding clustering and cable prices. First, the Commission applied its regression equation to last year's MSO Survey Data without applying any weighting to the system price information based on the number of subscribers taking the package of services and equipment it was measuring (*i.e.*, BST, the most highly penetrated CPST, the most widely used converter, and a remote). Such weighting is critical to producing more accurate regression results.[39] Fess and Woock therefore reran the Commission's regression equation using the 1999 MSO Survey Data but only after appropriately weighting the system price by the number of subscribers taking this set of services and equipment.[40] The results of this weighted regression analysis -- which are set out in Appendix B

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[38] AT&T attaches to these comments the declarations of Ms. Fess and Mr. Woock which describe the work they undertook and attest to the accuracy of the data and analysis included in these comments.

[39] This is particularly true since the Commission did not include subscriber counts as a relevant variable in its regression equation.

[40] The Commission supplied AT&T with the Excel database containing the MSO survey data on which the *1999 Price Report* was based. Fess and Woock used this same database in performing this weighted regression analysis (and its other analyses of the 1999 MSO Survey Data). AT&T notes that this weighted regression analysis did not include the median household income variable. Prior to providing the 1999 MSO Survey Data to AT&T, the Commission had removed all potentially confidential system-identifying information, such as zip code. As a result, AT&T was not able to derive the median household income for each system in the database. However, the absence of the median household income variable in AT&T's weighted

(footnote continued ...)

-- confirm AT&T's finding based on its 2000 Survey Data, namely clustering is *not linked to higher cable prices*. In fact, since the coefficient of the clustering variable is negative and significant, this weighted regression suggests precisely the opposite conclusion, namely that, to the extent clustering has any effect on cable prices at all, it is to drive them *lower*, not higher. Seen in this light, the Commission's conclusion in its *1999 Price Report* that "operators that were part of a cluster had, on average, higher monthly rates than operators that were not part of a cluster" is incorrect.

Second, to its credit, the Commission acknowledged that its findings regarding clustering and consumer prices in the *1999 Price Report* "may be due to a variety of reasons not captured by the equation."[41] This is clearly true. For example, the regression equation fails to take into account the effect of programming cost increases on cable prices. The cable industry has repeatedly advised the Commission that programming costs are the single most important driver of higher cable prices,[42] and it was therefore inappropriate for the Commission to suggest that there is an inverse relationship between clustering and consumer cable prices without factoring a system's programming costs into its analysis.

(... footnote continued)

regression analyses would have no practical effect on the results since the Commission's regression results showed that household median income was not a statistically significant variable. *See 1999 Price Survey* at D-1 (indicating that the coefficient for the Log of Median Household Income variable was .017, with a standard error of .021).

41 *1999 Price Report* at Appendix D-1.

42 *See 1999 Video Competition Report* at ¶ 26 (noting that license fees paid by cable operators to basic cable network programmers increased by 14.6% between 1998 and 1999, and are projected to increase another 10.9% this year); *1998 Video Competition Report* at App. F (noting that average expenditures for programming increased by 20.2% between 1996 and 1997).

Similarly, the Commission's regression did not include variables for whether the system offers local telephony or Internet access, the number of subscribers in the franchise generally, or the number of subscribers to the specific package of services and equipment whose price was being analyzed in the regression. To see what effect these relevant variables would have, Fess and Woock ran a modified regression, including these variables, using AT&T's 2000 Survey Data. The results -- which are included in Appendix C -- show that inclusion of these four new variables rendered the clustering co-efficient insignificant, thereby re-confirming that clustering is not linked to higher cable prices.

Fess and Woock also ran this same modified regression (with the four new variables) using the 1999 MSO Survey Data. The results -- which are included in Appendix D -- once again show that the clustering coefficient is statistically insignificant, thereby reinforcing that clustering is not linked to higher cable prices.[43]

Finally, by focusing on a system's *cable* prices, the Commission's analysis fails to consider that clustering, by facilitating the offering and packaging of multiple video and non-video services, will yield lower *overall* prices (in addition to greater choice) for American consumers. In fact, as shown in the section below, the Commission has previously recognized this fact, and the packaging and discounting of services currently being offered by AT&T and others confirms it.

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[43] In fact, even putting aside the regression equation, AT&T's data show that the difference in cable pricing between clustered and non-clustered systems is insignificant. Specifically, the average price per channel for BST, the most highly penetrated CPST, the most widely used converter, and a remote was $0.58 for AT&T's clustered systems covered by AT&T's 2000 Survey Data and $0.60 for the non-clustered systems. Ms. Fess performed a standard t-test on the difference between these two per-channel prices and found that the difference is not statistically significant.

* * *

Based on the foregoing, AT&T respectfully urges the Commission to clarify in its report to Congress that the statements in the *1999 Price Report* questioning the benefits of clustering were incorrect. At the very least, the Commission should note that last year's findings are now superceded by the data and econometric analyses supplied by AT&T which confirm that clustering *does* provide significant consumer benefits, including the accelerated rollout of local telephony and high-speed Internet access, but *does not* cause higher cable prices.

III. THE PACKAGING OF VIDEO AND NON-VIDEO SERVICES HAS BECOME AN IMPORTANT CHARACTERISTIC OF THE COMMUNICATIONS MARKETPLACE AND IS PRODUCING SIGNIFICANT CONSUMER BENEFITS IN TERMS OF INCREASED CHOICE AND LOWER PRICES.

The Commission seeks comment on a number of issues associated with the packaging of video and non-video services.[44] Below, AT&T provides specific data illustrating that such service packaging creates greater choice, lower prices, and better value for consumers. AT&T also notes that service packaging has become common among major communications providers.

A. AT&T's Offering of Packaged Services Is Fostering Competition in Local Phone Markets.

When Congress passed the 1996 Act, it observed that cable companies provide the best hope for broad-based competition in the local phone market. Today, AT&T and other cable companies are investing billions of dollars to upgrade their networks in an effort to provide cable telephony and advanced broadband services to millions of Americans. The local phone monopolies, however, have dominated their respective phone markets for generations, and their bottleneck facilities have proven enormously resistant to competition. Hence, in order to bring the benefits of local telephone competition -- lower prices, improved customer service, and

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44 *See* NOI at ¶¶ 49-50.

technological innovation -- to consumers across the country, cable companies must work to achieve various network efficiencies. Clustering, as noted above, is one key strategy for achieving such network efficiencies. The packaging of communications services is another.[45] Consumers like the idea of one-stop shopping for multiple services, and AT&T and other cable operators are responding to that demand.[46]

AT&T has already been offering customers packages that may include all-distance phone service as well as wireless and narrowband Internet access,[47] and is now in the process of rolling out broadband product packages as well. Over the last year, for example, AT&T ran marketing campaigns in Texas, California, and Illinois that packaged digital cable service and long-distance service.[48] Under the plans offered in Texas and California, customers who took both services received a 10% discount on both bills for up to one year, while the plan offered in Illinois gave

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[45] A recent survey found that 84% of consumers want local telephony in their service package. *See* Jeff Baumgartner, *Bundling, Marketing Drive Telephony*, Multichannel News, July 24, 2000, at 59 (citing recent Strategis Group study).

[46] The offering of packaged services has also helped cable operators respond to vigorous competition from DBS providers. *See* Stern, *supra* n. 9 (noting, for example, that Cox's ability to compete effectively with DBS is "a direct result of its success in building a network that provides digital cable and high-speed Internet services").

[47] AT&T's "One Rate" plans have attracted over 9 million customers. AT&T has been successful in packaging services in the consumer market by giving customers the option of intra-LATA service with its One Rate offers. Specifically, over 60% of the customers enrolled in One Rate have chosen AT&T as their intra-LATA provider. In addition, AT&T's any-distance New York Local One Rate offer that combines both local and long distance service has resulted in 500,000 net customers since its introduction. *See AT&T Earnings Report* at 8.

[48] In total, AT&T offered cable-long distance packages in ten markets. *See* Monica Hogan, *AT&T Grows A Marketing Team*, Multichannel News, July 24, 2000, at 6 (discussing marketing of packaged services).

customers $5 off the cable bill for up to a year.[49] AT&T has also been conducting customer trials in Florida and Massachusetts of different multi-product packages that include a mix of digital video, cable modem, and cable telephony services. Under some of those plans, customers can buy two of the three services and receive discounts based on the services selected,[50] or subscribe to all three services and get at least a $26 monthly discount plus free installation. AT&T plans to make these packaged offerings -- as well as others involving a mix of broadband and traditional telephone services -- available in more markets as systems continue to be upgraded and billing and provisioning systems are put in place.

B. Packaging of Services Has Become Commonplace in the Communications Industry.

As the Commission observed in the *AT&T/MediaOne Merger Order*, the packaging of services has the potential to provide substantial benefits for consumers, particularly in the form of enhanced choice and lower prices for services.[51] The recent proliferation of service packages

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[49] *See* Letter from Joan Marsh, AT&T, to To-Quyen Truong, Cable Services Bureau, filed in CS Docket No. 99-251, at 4 (Nov. 23, 1999).

[50] Under one plan, for example, a customer who subscribed to digital video and telephone service would get 25% off his or her telephone bill for one year and free installation, while a customer who took digital video and high-speed Internet service would receive a $10 monthly discount.

[51] *See In the Matter of Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from MediaOne Group, Inc. to AT&T Corp.*, Mem. Opin. & Order, CS Docket No. 99-251, FCC 00-202, at ¶ 141 (rel. June 6, 2000) ("*AT&T/MediaOne Merger Order*") at ¶ 141 ("[A] blanket condition prohibiting bundling of any form could have the unintended effect of denying consumers substantial benefits. The merged firm may well have lower costs in billing and servicing customers that subscribe to several of its offerings. In such a case, the merged firm could pass its cost savings to consumers in the form of lower prices. Purchasing the package of bundled services thus could be cheaper than the sum of purchasing each of the bundled services on a stand-alone basis."). *See also In the Matter of Applications for the Consent to Transfer of Control of Licenses and Section 214 Authorizations from Tele-Communications, Inc. to AT&T Corp.*, Mem. Opin. & Order, 14 FCC Rcd. 3160, at ¶ 125 (1999) ("*AT&T/TCI Merger Order*") (same).

demonstrates that such consumer benefits are not merely speculative. As noted, AT&T has been a pioneer in these marketing efforts -- first with its One Rate plans, and now with its broadband service packages -- and numerous communications providers are following suit.[52] Southwestern Bell, a subsidiary of SBC, is offering its customers in Texas a "Full Solution" plan that includes local and long distance phone, Internet, wireless, and DirecTV video services.[53] Likewise, RCN, a major cable overbuilder, is now marketing its "ResiLink" packages to more than 145,000 homes on the East and West Coasts.[54] Knology, an overbuilder in the South, also offers discounts for its service packages.[55] Several major telephone providers, including Verizon,

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[52] The decisions by incumbent LECs to offer high-speed Internet and video services, in addition to their traditional phone services, have often come as a competitive response to the aggressive broadband deployment efforts of AT&T and other cable operators. *See, e.g.*, *Broadband Today: A Staff Report to William Kennard, Chairman of the Federal Communications Commission*, Cable Services Bureau, FCC, at 29 (1999) ("The ILECs' aggressive deployment of DSL can be attributed in large part to the deployment of cable modem service."); Remarks of FCC Chairman William E. Kennard Before the Federal Communications Bar Association's Northern California Chapter, San Francisco, CA (July 20, 1999) ("Where cable modem service has been introduced, DSL has followed.").

[53] *See Residential Products and Services: Full Solution*, *at* http://www.swbell.com/ Products_Services...1/Prodinfo_1/1,973,147-0-6-3-0,00.html (visited Aug. 17, 2000) (noting that subscribers to Full Solution plan could obtain savings of up to 21% less than would be paid for services on a stand-alone basis).

[54] *See RCN Introduces Its Bundled Communications Services to Residents in Dedham and Arlington, Mass*, PR Newswire (Aug. 4, 2000); John H. Higgins, *RCN's High-Wire Act*, Broadcasting & Cable, May 8, 2000, at 22. The various ResiLink plans generally offer a package of four services: local and long distance telephony, video, and high-speed Internet access. *See ResiLink: Bundled Services Saving You Money*, *at* http://www.rcn.com/resilink/main.html (visited Aug. 17, 2000) (noting that plan is "enhanced with pricing plans to save you money").

[55] *See Bundled Communications Is A Combination Of Knology Telephone, Cable TV and Internet Service*, *at* http://www.knology.com/residential/index.cfm (visited Aug. 17, 2000) (noting various discounts for phone, Internet, and video services). Other cable operators are also starting to market telephony to their video and cable modem customers. *See, e.g.*, *Cox Digital Telephone: Questions and Answers*, *at* http://www.cox.com/SanDiego/Telephone/default.asp?c=main.asp&>> (visited Aug. 18, 2000) (noting availability of all-distance phone service in

(footnote continued ...)

Sprint, and MCI WorldCom, provide packages of all-distance phone services,[56] and many such providers now or will soon offer their customers a video option as well.[57]

Many packaged offerings, particularly those involving a mix of video and non-video services, have just been introduced, so it is still too early to gauge consumer response. Nonetheless, every indication is that there will be strong demand for the plans. As noted,

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(... footnote continued)

Cox's San Diego system and that existing Cox customers receive preferred rate on telephone service). AT&T is also partnering with other cable operators to provide service packages. *See, e.g.*, *AT&T and Cablevision Systems Corporation Unveil Plans to Give Customers "Something Extra,"* Cablevision Press Release (May 4, 2000) (noting that Cablevision and AT&T plan to launch their "Something Extra" rewards program to consumers in the New York metropolitan area who take both video services from Cablevision and phone service from AT&T); *Insight Communications and AT&T Finalize Agreement to Offer Local Telephone Service*, Insight Press Release (July 24,2000) (noting agreement under which Insight will market AT&T's local telephone service as part of a package of telecommunications and cable services to Insight customers); *AT&T and Time Warner Cable Announce Joint Marketing Agreement*, Time Warner Press Release (March 8, 2000) (noting that under marketing agreement in Albany and Syracuse, New York, customers who choose Time Warner cable television and AT&T communications services will benefit from a variety of incentives including, among other possibilities, long distance minutes and pay-per-view movies).

[56] *See, e.g.*, Michael McDonald, *Bell Scoring Big Gains With Long Distance*, Crain's New York Business, July 17, 2000, at 1 ("Bell Atlantic has found some of its greatest success, officials say, by combining low long-distance rates with discounts on premium local service."); *Plan Comparisons*, *at* http//clec.sprint.com/servlet/CLEC?PAGE=TOCOMPARE&MKT=0001 (visited Aug. 17, 2000) (noting that subscribers to Sprint's packaged local and long distance service receive $5 off their phone bills every month for the next 12 months); *MCI WorldCom Local Service For Home*, *at* http://www.mci.com/aboutus/products/local/NY3.shtml (visited Aug. 17, 2000) (describing phone packages).

[57] BellSouth, for example, provides competitive digital MMDS video services in areas of the Southeast, while Sprint and MCI WorldCom have acquired most of the larger MMDS operators in recent years with the intent of using the acquired frequencies to provide two-way communication services. *See 1999 Video Competition Report* at ¶ 86. Verizon and SBC, in contrast, have partnered with DirecTV to provide video services to their customers. *See Full Solution*, *supra* n. 53; Monica Hogan, *Bell Brings Bundle to Boston*, Multichannel News, March 20, 2000, at 30 (noting that Bell Atlantic was partnering with DirecTV to provide packaged offerings of video, high-speed Internet and wireless phone services to Boston-area customers).

AT&T's packages have enjoyed a favorable response, as have those of other providers.[58] Moreover, several reports issued earlier this year indicate that consumers want a single provider for most or all of their communications services.[59] One survey found that 93 percent of residential consumers surveyed reported an interest in some type of service package and 78 percent said that price discount is the main reason they would choose packaged services from a single-source provider.[60] A second report concluded that convenience, or the desire to receive a single bill and deal with one company, was the most important factor in determining consumer interest in packaging services.[61]

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In sum, as the foregoing discussion makes clear, AT&T and most other communications providers are aggressively pursuing the packaging of video and non-video services over their networks. Such packaged offerings afford consumers greater choice, lower prices, and better value. The Commission should therefore continue to refrain from restricting packaging in order to avoid the "unintended effect of denying consumers substantial benefits."[62]

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58 *See, e.g.* Higgins, *supra* n. 54, at 22, 28 (noting that after RCN introduced its ResiLink plan, the average number of broadband services purchased by its subscribers increased from 2.2 to 3.3).

59 *See* Craig Kuhl, *Survey: Customers Want the Bundle*, Multichannel News, Feb. 7, 2000, at 43 (discussing findings of Strategis Group study); *Nearly 50 Percent of Consumers Surveyed Want a Single Provider For All Telecommunications Services*, J.D. Power and Associates Report (Feb. 9, 2000).

60 *See* Kuhl, *supra* n. 59.

61 *See* J.D. Power Report, *supra* n. 59.

62 *See AT&T/MediaOne Merger Order* at ¶ 141.

IV. THE COMMISSION'S RECENT CHANGES TO THE CABLE OWNERSHIP RULES DO NOT GO FAR ENOUGH TO REFLECT THE CURRENT STATE OF THE VIDEO MARKETPLACE, AND IN CERTAIN KEY WAYS CONTINUE TO PRODUCE HARMFUL AND ARBITRARY RESULTS.

The *NOI* also notes the recent changes the Commission made to the cable horizontal ownership and attribution rules, and invites comment on the impact of these revised rules on competition in the cable television market.[63] While AT&T supports the Commission's decision to change the horizontal ownership formula from a cable homes passed-based test to an MVPD subscriber-based test,[64] it continues to believe that the Commission missed an opportunity to make changes to the rules that would more accurately reflect the competitive state of the video marketplace today. As a result, in several key ways, both the revised cable ownership and attribution rules remain arbitrary and overly restrictive.

A. Revised Cable Ownership Rules.

Several aspects of the revised ownership rules highlight their arbitrary and overly restrictive nature. First, as AT&T has noted, the revised rules only account for the impact of DBS and other competing non-cable MVPD providers by including all MVPD subscribers in the definition of the relevant "market" and prescribing that the calculation of each MSO's share should be based on all MVPD subscribers.[65] However, DBS and other competition provide obvious and powerful incentives for a cable operator to base its programming decisions on what will attract the greatest number of customers to its system. Thus, in determining whether cable

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63 *See NOI* at ¶13.

64 *See In the Matter of Implementation of Section 11(c) of the Cable Television Consumer Protection and Competition Act of 1992: Horizontal Ownership Limits*, Third Rept. & Order, 14 FCC Rcd. 19098, at ¶¶ 27-35 (revising ownership formula) (1999) ("*Third Report & Order*").

65 *See* Brief for Cable Operator Petitioners, *Time Warner Entertainment, L.P., et al. v. FCC, et al.*, Case No. 94-1035 (D.C. Cir.), filed March 7, 2000, at 20 ("AT&T Ownership Brief").

companies of a particular size would have the incentive and ability to decline to carry desirable, competitively-priced video programming, the Commission must necessarily consider the impact of customers switching to competitors that *do* carry that programming on the profitability of such a strategy. The Commission must also consider the impact of MVPD competition in determining whether an MSO of a particular size has market power. By considering MVPD competition for one purpose but not the other, the revised rules are internally inconsistent.

Second, determining whether cable operators of a particular size could harm video programming suppliers requires an assessment of the impact that broadcasters and other purchasers of video programming have on a cable operators' ability to dictate unfair terms. However, rather than address any market for the production and sale of video programming on the basis of an assessment of *all* purchasers of that programming, the Commission's rules instead focus solely on the purchase of *cable programming services*, which are aggregations of video programming that are assembled and produced for distribution by cable or other MVPD systems. Broadcasters are not the only oversight in this respect. The rules ignore foreign cable operators who purchase and distribute vast amounts of video programming. MTV, for example, is now viewed by 300 million people in 83 countries, and HBO has a presence in over 40 countries. The rules also ignore producers of videocassettes and video discs whom the FCC has elsewhere found to be substantial purchasers of video programming.[66] As a result, application of the rules overstates the size and significance of cable operators' video programming purchases.

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66 *Id.* at 21-22.

Third, the Commission's retention of the 30% limit has no support. For example, AT&T has previously demonstrated that the Commission's assumption of collusion is unfounded.[67] In fact, as AT&T has shown, substantial legal, policy, and economic analyses, as well as real-world data, justify a cable horizontal ownership limit of at least 40%.[68]

Finally, there is no basis for the Commission to set a horizontal ownership limit for cable operators lower than the 35% level it adopted for broadcasters. In raising the broadcast horizontal ownership limit, the Commission reaffirmed its view of broadcasters as a "uniquely important" distribution mechanism in terms of ensuring programming diversity: "There is consequently a vital public interest in ensuring that these influential outlets for communications are in the hands of a broad number of different owners."[69] But if a 35% horizontal ownership limit is not too high to cause concerns about monopsony, vertical foreclosure, or diversity for the "uniquely important" broadcasters, *a fortiori*, such a limit cannot reasonably be viewed as a problem for the cable industry, particularly given the industry's well-established track record in

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67 *Id.* at 29-30.

68 *See, e.g., AT&T Ex Parte Letter and Economic Affidavit of Dr. Janusz A. Ordover*, filed in MM Docket No. 92-264 (Horizontal Ownership Limits) and CS Docket No. 98-82 (Cable Attribution Rules) (Oct. 1, 1999) (including references to all legal, policy, and economic analyses submitted by AT&T supporting at least a 40% limit and changes to the cable attribution rules).

69 *See Review of the Commission's Regulations Governing Television Broadcasting, Television Satellite Stations Review of Policy and Rules*, MM Docket Nos. 91-221 and 87-8, at ¶ 18 (rel. Aug. 6, 1999). The Commissioners echoed these conclusions in their individual statements. Commissioner Ness, for example, observed that "broadcasting remains a distinctly special service -- with unique privileges and unique responsibilities." Statement of Commissioner Ness at 2. Commissioner Powell agreed that the "free business model [of broadcasters] is quite unique and . . . warrants some government attention to undue concentration." Statement of Commissioner Powell at 2.

promoting diverse programming notwithstanding increases in MSO size.[70] This is especially true when one considers that under the broadcast limit the Commission only counts 50% of homes reached by UHF (and also grandfathers LMAs and exempts satellite TV stations), so that broadcasters are able to own stations that reach substantially more than 35% of all television households. This is why, for example, Paxson and other broadcasters can tout that their networks reach over 60% of American television households.[71]

B. Revised Cable Attribution Rules.

The revised cable attribution rules are similarly arbitrary and overly restrictive. The attribution rules can result in the double, triple, and additional counting of subscribers in certain cable systems in which two (or more) operators have an attributable interest. For example, an investor with a 5% voting interest is attributed with all of the subscribers of a cable system even if there is another investor who holds the remaining 95% of voting control.[72] Likewise, if twenty

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[70] The Commission has argued that its change to an MVPD subscriber-based test "effectively increased" the horizontal ownership limit to 36.7% because a 30% limit based on MVPD subscribers is "roughly equivalent to changing the rules to a 36.7% cable subscribers limit." *Third Report & Order* at ¶ 64. This characterization is wrong for two reasons. First, the Commission calculated 36.7% by dividing an MSO's *subscribers* by all *cable subscribers*. *Third Report & Order* at ¶ 37 and n.82. However, the previous rule divided an MSO's cable *homes passed* by all cable *homes passed*. So, assertions regarding an "effective increase" in the limit are based on a faulty premise. Second, in the *Third Report & Order*, the Commission recognized that retention of a purely cable-based approach was no longer appropriate as it would *overstate* an MSO's relative market share. *See Third Report & Order* at ¶ 28. Thus, the change to an MVPD subscriber-based test was necessary to correct any overstatement in terms of applying the horizontal ownership limit.

[71] *See, e.g.*, Paxson Communications Corp., Securities and Exchange Commission Form 10-K, at 7-8 (March 14, 2000) (indicating that Paxson reaches approximately 62.4% of U.S. prime time television households through broadcast stations it owns or operates or in which it has an economic interest).

[72] AT&T notes that this absurd result would not occur in the broadcast context in which the Commission retained the single majority shareholder exception. *See Third Report & Order*, Commissioner Furchtgott-Roth dissenting at 2 ("I see no rational justification for retaining this

(footnote continued ...)

entities each owned a 5% voting interest in a cable system, each would be attributed with the entire subscriber base of the system for purposes of the cable horizontal cap, in effect counting the same subscribers twenty times over. Such outcomes are unjustified, because they ascribe total ownership of a system to an "owner" who does not control or participate in the selection of video programming that is at the heart of the horizontal ownership rules.

Second, AT&T also has concerns with the revised insulation rules for limited partnerships ("LPs") and limited liability companies ("LLCs"). Although the Commission attempted to limit somewhat the scope of the insulation requirement in the context of the cable horizontal and channel occupancy areas to the video programming activities of LPs and LLCs,[73] the rules, as construed by the Commission, continue to be overly inclusive. The rules require a limited partner to refrain from performing "any services for the partnership materially relating to its video-programming activities," which, the Commission now has held, encompasses any programming "affiliation agreement" between the limited partner and the limited partnership.[74] In other words, the Commission infers that a limited partner is "materially involved" in the limited partnership's programming choices from the mere fact that the limited partnership has chosen to buy video programming owned by the limited partner, whether or not the limited

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(... footnote continued)

exception for broadcasters but repealing it for cable operators, and I do not think the Order provides one.").

[73] *See In the Matter of Implementation of the Cable Television Consumer Protection and Competition Act of 1992: Review of the Commission's Cable Attribution Rules*, Rept. & Order, 14 FCC Rcd. 19014, at ¶¶ 63-64 (revising insulation rules for LPs), ¶ 68 (revising insulation rules for directors and officers), ¶¶ 71-73 (applying insulation rules to LPs to LLCs) (1999) ("*Cable Attribution Order*"). *See also* 47 C.F.R. § 76.503, Note 1(b) (revised LP and LLC insulation rules for ownership cap); *id.* § 76.503.

[74] *Cable Attribution Order* at ¶ 106.

partner played any role in the partnership's decision. Thus, for example, under the Commission's interpretation of its rules, an investor that has only a 1% limited partnership interest in an entity and which meets all of the criteria for insulation from video programming activities set out in the Commission's rules would still be attributed with 100% of the partnership's subscribers simply because it (or its affiliate) sells a single program service to the partnership. This would be the result even if the 1% limited partner had no involvement at all in determining what program services the system management decided to carry.

While the Commission's overly restrictive interpretation of its insulated LP rules is unjustified in its own right, equally problematic is that going forward this interpretation will discourage companies from pursuing LP and LLC interests, a result that is at odds with state and federal laws that *promote* the use of such corporate structures. LPs and LLCs have been increasingly pursued by businesses given the "pass through taxation" and other benefits offered by such corporate forms.[75] For example, LLCs are attractive to businesses because, in addition to the tax advantages, such entities are: (i) less expensive to create and administer; (ii) subject to less government regulation of their corporate governance (*e.g.*, dissolution rights, buy-out provisions, and court-determined minority protection are optional); and (iii) eligible for limited liability protections.[76]

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[75] With "pass-through taxation," an LP or LLC does not pay a corporate tax but, instead, passes on its profits and losses directly to its owners/members, who then record the profits or losses on their respective tax returns). *See, e.g.*, 26 U.S.C. § 701 (requiring partners, rather than partnership, to pay federal tax on partnership's income); Rev. Rul. 88-76, 1988-2 C.B. (1988) (classifying LLC as a partnership for federal tax purposes).

[76] *See* Lucy Jokiel, *A New Way to Do Business*, Island Business, June 1, 1997 (available at 1997 WL 18365645) (discussing pass-through taxation); Debra Cohen-Whelan, *Individual Responsibility in the Wake of Limited Liability*, 32 U.S.F. L. Rev. 335, 340 (1998) (describing other advantages of LLCs).

In fact, many states have enacted LLC statutes precisely because they believe that the tax and operational benefits of this corporate form will encourage greater local investment and business development.[77] The Commission's insulation rules for LPs and LLCs, however, work at cross-purposes with these state statutes and relevant federal tax law by significantly expanding the potential for attribution and violation of the horizontal ownership limit and cross-ownership rules. For example, an investor who was considering making a 5% passive LP investment in a rural cable television system might refrain from doing so if the investor's (or its affiliate's) sale of programming to the system would attribute the investor with the cable system (notwithstanding its certification to have absolutely no role in the video programming operations of the cable system) and such attribution caused a cross-ownership problem for the investor who also was attributed with a public television station in the same area. The Commission's overly restrictive treatment of LP and LLC interests for attribution purposes will in this and many other instances deter such private investment even as the IRS's and states' treatment of LPs and LLCs is designed to foster it. It is incongruous for sister agencies to have such inconsistent approaches to this issue, particularly when the end result could be reduced investment and business development. AT&T respectfully submits that the Commission could avoid such an unreasonable outcome by *not* attributing the interest of a truly passive LP or LLC investor who

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[77] *See, e.g.*, Roger C. Siske, *Current Issues for Executive Compensation*, SD07 A.L.I.-A.B.A. 199, 212 (1998) (noting that following the Internal Revenue Service's determination in 1988 that an LLC organized under Wyoming's LLC Act was a partnership for federal income tax purposes, "various states began implementing LLC statutes as a means of encouraging local investment and business development." Also noting that "[l]egislators in Florida, one of the earlier states to adopt an LLC statute, intended to lure investors from Central and South America countries by giving such investors access to a form of business association currently utilized in these countries.").

certifies that it meets the seven Commission criteria for insulation,[78] even if such investor (or its affiliate) sells video programming to the LP or LLC.[79]

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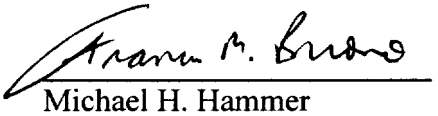
[78] *See Cable Attribution Order* at ¶ 64 (listing insulation criteria for LP interests); 47 C.F.R. § 76.503, Note 1(b) (insulation rules for LP and LLC interests).

[79] Ironically, in some instances, the Commission's overly restrictive treatment of LP and LLC interests could inadvertently encourage *increased* concentration in ownership. By attributing cable subscribers or cable systems to truly passive minority LP or LLC investors, the Commission's rules may create an incentive for investors with attribution concerns but with substantial capital to forgo limited interests in favor of complete ownership. Permitting an investor to possess a limited interest in an LP or an LLC, which, by the terms of the respective agreements and Commission certification, prevents the investor from being involved in video programming activities, promotes diversity in ownership and programming and does not create an artificial incentive to pursue a greater ownership interest.

V. CONCLUSION

For the foregoing reasons, AT&T respectfully urges the Commission to adopt a report to Congress that is consistent with the comments herein.

Respectfully submitted,



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APPENDIX A

FCC Regression Analysis Using AT&T 2000 Survey Data

Variable	Coefficient	Standard Error	N=128, Adjusted R-Squared=.3597
Low Penetration Dummy	null	null	This has no effect on the regression since all 128 records have a 0.
LEC Dummy	-0.168	0.031	
Municipal Dummy	-0.297	0.066	
Overbuild Dummy	-0.106	0.066	
MSO Dummy	null	null	This has no effect on the regression since all 128 records have a 1.
Log of Reciprocal of Avg. Total Channels	-0.236	0.054	
Log of Median Household Income	0.030	0.032	This has no significant effect on the regression since the coefficient is not significantly different from zero.
Cluster Dummy	0.013	0.018	This has no significant effect on the regression since the coefficient is not significantly different from zero.
Constant	2.282	0.36	

APPENDIX B

FCC Regression Analysis Using MSO 1999 Survey Data But Weighting System Prices By Number of Subscribers

Variable	Coefficient	Standard Error	N=725, Adjusted R-Squared=.3636. Median Household Income was not available to include in this analysis.
Low Penetration Dummy	0.027	0.017	
LEC Dummy	-0.173	0.013	
Municipal Dummy	-0.250	0.054	
Overbuild Dummy	-0.046	0.022	
MSO Dummy	-0.050	0.038	
Log of Reciprocal of Avg. Total Channels	-0.268	0.020	
Cluster Dummy	-0.035	0.006	Since this coefficient is negative and significantly different from zero, it pushes the average price downward.
Constant	2.510	0.091	

APPENDIX C

FCC Regression Analysis Using AT&T 2000 Survey Data But Modified to Include Four New Variables

Variable	Coefficient	Standard Error	N=128, Adjusted R-Squared=.3795
LEC Dummy	-0.185	0.031	
Municipal Dummy	-0.293	0.065	
Overbuild Dummy	-0.092	0.066	
Log of Reciprocal of Avg. Total Channels	-0.212	0.059	
Log of Median Household Income	0.042	0.034	
Cluster Dummy	0.011	0.019	This has no significant effect on the regression since the coefficient is not significantly different from zero.
Internet Service Dummy (Line C10)	0.034	0.018	Since this coefficient is positive, it pushes the average price upward.
Telephony Service Dummy (Line C12)	0.006	0.035	This has no significant effect on the regression since the coefficient is not significantly different from zero.
Log of Franchise Subscribers (Line C4)	0.025	0.012	
Log of Subscribers of this Service (Line E6b)	-0.021	0.011	
Constant	2.184	0.372	

APPENDIX D

FCC Regression Analysis Using MSO 1999 Survey Data But Modified to Include Four New Variables

Variable	Coefficient	Standard Error	N=680, Adjusted R-Squared=.3626 Median Household Income was not available to include in this analysis.
Low Penetration Dummy	0.027	0.013	
LEC Dummy	-0.155	0.016	
Municipal Dummy	-0.346	0.058	
Overbuild Dummy	-0.031	0.021	
MSO Dummy	-0.037	0.024	
Log of Reciprocal of Avg. Total Channels	-0.316	0.021	
Cluster Dummy	-0.013	0.010	This has no significant effect on the regression since the coefficient is not significantly different from zero.
Internet Service Dummy (Line C10)	0.030	0.012	Since this coefficient is positive, it pushes the average price upward.
Telephony Service Dummy (Line C12)	0.011	0.025	This has no significant effect on the regression since the coefficient is not significantly different from zero.
Log of Franchise Subscribers (Line C4)	0.007	0.023	This has no significant effect on the regression since the coefficient is not significantly different from zero.
Log of Subscribers of this Service (Line E6b)	-0.004	0.023	This has no significant effect on the regression since the coefficient is not significantly different from zero.
Constant	2.176	0.099	

BEFORE THE

Federal Communications Commission

WASHINGTON, D.C.

In the Matter of	)	
	)	
Annual Assessment of the Status of	)	CS Docket No. 00-132
Competition in the Markets for the	)	
Delivery of Video Programming	)	

DECLARATION OF JENNIFER FESS

I, Jennifer Fess, do hereby declare as follows:

1. I am a member of the technical staff in Management Science Applications at AT&T Labs - Broadband. My business address is: AT&T Labs - Broadband, 10355 Westmoor Drive, Suite 100, Westminster, CO 80021.

2. I have degrees in Mathematics (BS) and Applied Mathematics (MS), with an emphasis in Statistics. I have over six years of experience in statistical programming, analysis, and experimental design. I have performed statistical analyses previously in a number of broadband service areas, including Internet telephony, high-speed data, and video.

3. I have reviewed the Commission's analysis of pricing and advanced service offerings in clustered and non-clustered cable systems in its *1999 Price Report*, as well as the regression employed by the Commission as part of this analysis.

4. I have also reviewed the data provided by AT&T in response to the Commission's *2000 Price Survey*, including data on pricing and advanced service offerings in its clustered and non-clustered systems. In addition, I have performed a regression on that data using the Commission's regression equation from the *1999 Price Report*, as well as a regression that employed additional variables, including the offering of telephony and high-speed Internet access services. I also performed modified versions of the Commission's regression on the MSO data that formed the basis

of the Commission's *1999 Price Report.* My findings have been incorporated in Section II and Appendices A through D of the foregoing Comments of AT&T.

5. I have reviewed these Comments and the Appendices. To the best of my personal knowledge, information, and belief, the statements made and data included in Section II and Appendices A through D accurately reflect the analysis I performed and the results I obtained. I fully concur in the conclusions drawn in Section II and in the critiques of the Commission's regression equation.

6. I declare under penalty of perjury under the laws of the United States that the foregoing is true and accurate.

Jennifer Fess

Jennifer Fess

September 6, 2000

BEFORE THE

Federal Communications Commission

WASHINGTON, D.C.

In the Matter of	)	
	)	
Annual Assessment of the Status of Competition in the Markets for the Delivery of Video Programming	)))	CS Docket No. 00-132

DECLARATION OF RODGER A. WOOCK

I, Rodger A. Woock, do hereby declare as follows:

1. I am the Director of Management Science Applications at AT&T Labs - Broadband. My business address is: AT&T Labs - Broadband, 10355 Westmoor Drive, Suite 100, Westminster, CO 80021.

2. I have a Ph.D. in Economics from the University of Illinois, and have twelve years of experience performing statistical and econometric analyses in the telecommunications field. I have worked at Bellcore, U S West, Advanced Technology, MediaOne Labs, and now AT&T Labs - Broadband. My areas of expertise include, among other things: Product and Market Forecasting; Regulatory and Antitrust Economic Analysis; Business Decision and Risk Analysis; and Financial Valuation and Analysis.

3. I am the supervisor of Jennifer Fess at AT&T Labs - Broadband, and have reviewed her analyses of the Commission's *1999 Price Report,* as well as the data provided by AT&T for the *2000 Price Survey*, including the regressions performed on that data.

4. I have also reviewed the foregoing Comments of AT&T, including Appendices A through D. To the best of my personal knowledge, information, and belief, the statements made and data included in Section II and Appendices A through D of the Comments are accurate and well grounded in fact. I fully concur in the conclusions drawn in Section II and in the critiques of the Commission's regression equation.

5. I declare under penalty of perjury under the laws of the United States that the foregoing is true and accurate.

Rodger A. Woock

September 6, 2000