BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

In the Matter of	)	
	)	
Implementation of Section 304 of the	)	CS Docket No. 97-80
Telecommunications Act of 1996	)	
	)	
Commercial Availability of Navigation Devices	)	

COMMENTS OF AT&T CORP.

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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 Further Notice of Proposed Rule Making ("*Notice*") in the above-captioned proceeding.[1]

I. INTRODUCTION AND SUMMARY

AT&T shares the Commission's commitment to promoting the retail availability of cable set-top boxes and other navigation devices, and is moving aggressively to promote retail sale. In fact, AT&T has particularly strong incentives to pursue retail sale of its digital equipment and services. AT&T's competitors, DirecTV and EchoStar, have enjoyed remarkable success at retail in recent years. Their significant retail presence has enabled them to achieve a combined 16.4% national share of MVPD customers, and they are taking four out of every five new multichannel video customers. AT&T must establish a retail presence in order to remain competitive in this hotly contested marketplace.

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[1] *In the Matter of Implementation of Section 304 of the Telecommunications Act of 1996: Commercial Availability of Navigation Devices*, Further Notice of Proposed Rule Making and Declaratory Ruling, CS Docket No. 97-80, FCC 00-341 (rel. Sept. 18, 2000) ("*Notice*").

In this regard, AT&T has announced a number of relationships with leading consumer electronics manufacturers and retailers, including Philips, Panasonic, and Best Buy, for the development, deployment, and marketing of advanced digital set-top boxes at retail. AT&T is pursuing similar agreements with other consumer electronics equipment vendors and retailers, as well, and is already conducting trials with Circuit City for the marketing of digital cable service and the sale of "integrated" set-top boxes (*i.e.*, those boxes containing embedded security). Moreover, AT&T intends that going-forward all advanced digital set-top boxes which it purchases for deployment on AT&T's cable systems will be equipped with a POD interface, and that by 2005 all equipment vendors, including those operating under existing supply contracts with AT&T, will provide POD-equipped boxes to AT&T.

AT&T's retail sale goals have been advanced by CableLabs' OpenCable effort which has yielded a viable technological foundation for the development of a retail market for host navigation devices. AT&T has participated extensively in the OpenCable initiative, has purchased POD modules built to OpenCable specifications, and fully supports CableLabs' ongoing middleware initiative that will enhance the portability of host devices.

In light of these developments, AT&T believes the Commission should revisit its prior decision to ban integrated devices as of January 1, 2005. Not only is the ban unnecessary, it will deny consumers access to a cost-effective product choice. The record shows that a POD/host combination would cost approximately $75 to $90 more than an integrated device performing the same functions. As the U.S. Court of Appeals for the D.C. Circuit noted in its recent decision on the retail sale rules, barring consumers from obtaining "the most cost-effective product choice" would run counter to the pro-competitive, pro-consumer provisions of the commercial availability statute.

However, should the Commission elect to retain the integration ban, it should clarify that integrated cable devices *that are available for purchase by consumers at retail* are not subject to the ban. In addition, the Commission should clarify that the exemption in Section 1204(a)(2) of the Commission's commercial availability rules applies where integrated cable devices available at retail include not only embedded security but also a POD slot. This is the case because such POD-equipped devices can be used on any AT&T system across the country without a POD and on any non-AT&T cable systems with a POD.

In all events, the Commission should not accelerate the effective date of the ban on integrated devices. Arguments that such an accelerated schedule is required to encourage the sale of navigation devices at retail are without merit. The retail market for navigation devices is already developing, as AT&T's agreements with consumer electronics equipment manufacturers and retailers and the development of the OpenCable specifications confirm. As a result, accelerating the ban will needlessly deny consumers the opportunity to select equipment that may be more cost-effective and better-suited to their particular needs. Moreover, accelerating the ban would severely disrupt AT&T's equipment design, procurement, and deployment plans. Such a result would not only be unfair since AT&T (and all other MSOs) legitimately established business plans based on the 2005 date, but would also impair, if not entirely stifle, highly innovative product development efforts that are currently underway by AT&T and others. For example, accelerating the ban would force AT&T to redesign the advanced, digital set-top boxes it has ordered from Philips and Panasonic and likely would delay the rollout of new digital services for two to three years or more (*i.e.*, 18-24 months is the typical design/development cycle for set-top hardware and software, plus approximately 6 months for field testing once developed).

II. AT&T STRONGLY SUPPORTS THE RETAIL SALE OF ADVANCED DIGITAL SET-TOP BOXES AND IS INVESTING SUBSTANTIAL RESOURCES TO DEVELOP THE RETAIL MARKET.

The *Notice* invites comment on "any obstacles or barriers preventing or deterring the development of a retail market for navigation devices."[2] In particular, the Commission notes that Circuit City and other commenters in this and other proceedings have claimed that "without significant changes, incentives for development of a retail market do not exist."[3] Circuit City's assertions are plainly wrong. As an initial matter, AT&T has a powerful incentive to promote a retail channel for advanced set-top boxes. As all agree, DBS has emerged as a significant competitor to the cable industry, and the double-digit growth in DBS customers has been driven in part by its strong retail presence. In light of this competition -- and the fact that many consumers want and prefer a retail option for their video and other broadband services -- AT&T has a very strong interest in pursuing retail options for the sale of its equipment and services. Moreover, AT&T's interest in a retail strategy is not merely theoretical. AT&T has already negotiated significant agreements with leading equipment makers, including Philips and Panasonic, as well as retailers, such as Best Buy, for the development, deployment, and marketing of advanced set-top boxes and other navigation devices at retail.

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[2] *Notice* at ¶ 12.

[3] *Id.*

A. AT&T Has A Powerful Incentive To Promote Retail Sale Of Advanced Set-Top Boxes, Particularly In Light Of The Significant Competition It Faces From DBS Operators, Who Have Benefited From An Aggressive Retail Sale Strategy.

As AT&T and other commenters noted in the Commission's *Video Competition NOI*, competition in the MVPD marketplace is thriving.[4] In particular, DirecTV and EchoStar have achieved a combined 16.4% national share of all MVPD customers[5] and rank today as the third and sixth largest MVPDs, respectively.[6] DBS is growing 20 times faster than cable, and capturing four out of every five new MVPD customers.[7] In short, DBS is a powerful presence in the marketplace today, engaging in a fierce battle with cable for every customer.[8]

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[4] *See* AT&T Comments, filed in CS Docket No. 00-132, at 1-5 (Sept. 8, 2000) (highlighting competition from DBS); NCTA Comments, filed in CS Docket No. 00-132, at 5-26 (Sept. 8, 2000) ("NCTA Video Competition Comments") (describing competition from DBS, overbuilders, utilities, and phone companies); SBCA Comments, filed in CS Docket No. 00-132, at 6 & App. A (noting, among other things, that 44 states now have direct-to-home ("DTH") penetration rates of greater than 10% (compared to 40 states last year); 24 states show a penetration of more than 20% (compared to just 10 states last year); and 3 states now boast more than 30% DTH penetration).

[5] *See The Kagan Media Index*, Sept. 30, 2000, at 8.

[6] DirecTV currently serves over 9 million customers, including former PrimeStar customers, and EchoStar has over 4.7 million customers. *See US DTH Subscribers*, SkyReport, *at* http://www.skyreport.com/dth_us.htm (listing DTH customers in U.S. as of September 2000).

[7] *See* NCTA Video Competition Comments at 10. DirecTV has also stated 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.

[8] *See Pay-TV War Between DBS And Cable Heats Up*, at 1 (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).

A strong presence at retail has been critical to the satellite industry's growth. DBS providers have relied almost entirely upon the retail distribution of their equipment for their increased subscribership. DirecTV has focused on national electronics retail chains such as Circuit City, Best Buy, and RadioShack to add customers to its network.[9] EchoStar originally distributed its products and services through local and regional retailers.[10] Its retail distribution network now also includes national chains such as Sears and Target.[11] Both DirecTV and EchoStar acknowledge the importance of distributing their equipment and services through retail outlets. DirecTV's senior vice president of marketing and advertising has stated that DirecTV relies heavily on its retail relationships to acquire new customers.[12] EchoStar's vice president of marketing has said that EchoStar's retail distribution is very important to the promotion of its products, noting that: "Sears, for example, is close to everyone's neighborhood. It gives people a very convenient way to go for a demonstration of the product."[13] Furthermore, EchoStar stated in its 1999 Annual Report that most of its sales were a result of retail distribution of its products and services and that it intended "to enhance consumer awareness of [its] products by continuing

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[9] *See* Monica Hogan, *Dish vs. Dish: DirecTV Sues EchoStar Back*, Multichannel News, March 20, 2000, at 1. DirecTV's recent retail distribution arrangement with Blockbuster has been praised. *See DBS Industry Approaches Critical Fourth Quarter With Gold In Its Pockets*, Satellite News (Sept. 18, 2000) ("Of all the retail presentations we've seen and studied through the years (and there are many), we rate this one as extremely well done.").

[10] *See* Hogan, *Dish vs. Dish: DirecTV Sues EchoStar Back*, at 1.

[11] *See EchoStar Subpoenas Retail Records for Antitrust Suit*, Satellite Week (Sept. 4, 2000).

[12] *See* Monica Hogan, *Aiming for the Targets*, Multichannel News, July 17, 2000, at 16A. The company also maintains that retail is its "primary distribution channel." Hogan, *Dish vs. Dish: DirecTV Sues EchoStar Back*, at 1.

[13] Monica Hogan, *Dish Piles on the Retail Promotions*, Multichannel News, May 29, 2000, at 10.

to form alliances with nationally recognized distributors of other consumer electronics products."[14]

DBS' success at retail alone would give cable operators sufficient incentive to establish a retail presence for their products and services. But, more importantly, cable customers are demanding such a presence. AT&T customers have made clear that they want more convenient ways to learn about and buy digital products. Recent comments by senior AT&T officials underscore AT&T's commitment to responding to this consumer demand:

- "We can't ignore where customers are shopping. We now have products that can compete through retail stores. We must have a presence there. So when [consumers] make product-purchase decisions, we want to be there."[15]
- "[AT&T Broadband needs] to be where the customers are, and the retail channel is one key location for customer buying decisions. It drives me nuts that cable does not have the presence I want to see there."[16]
- "As consumers become busier, it's important for operators to make it easier to test or purchase new cable services."[17]
- "Retail will be important, not only as a distribution channel, but also as a source of information that will help [AT&T] work with consumer electronics manufacturers on innovative products for the future. Ultimately, we envision a wide range of consumer electronics devices available for purchase at retail that will operate on AT&T Broadband's network."[18]

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[14] EchoStar Communications Corp., SEC 10-K, at 8 (March 13, 2000).

[15] Craig Kuhil, *Retail Mentality Sinks In With Cable*, Multichannel News, Jan. 24, 2000, at 41 (quoting AT&T Broadband's senior vice president of marketing).

[16] Jeff Baumgartner, *AT&T Books Philips Order, Breaks Digital-Box Ranks*, Multichannel News, Aug. 21, 2000, at 37, 38 (quoting AT&T Broadband's chief technology officer).

[17] Monica Hogan, *AT&T Taps Best Buy As Retail Partner*, Multichannel News, Oct. 16, 2000, at 3, 90 (quoting AT&T Broadband's vice president of sales and distribution).

[18] Reuters, *Best Buy to Sell AT&T Broadband Services*, Oct. 11, 2000 (quoting AT&T Broadband's senior vice president of marketing).

These comments reflect a fundamental tenet of AT&T's business philosophy: AT&T is not in the business of selling or leasing *equipment*; it is in the business of providing high-quality, diverse, and innovative *services*. AT&T believes the retail availability of equipment for use on its systems will drive more consumers to become AT&T customers and will free up capital for AT&T to invest in new and enhanced services.[19] In short, the Commission does not need to accelerate the 2005 ban on integrated devices or to adopt the other extraordinary measures proposed by certain retailers, because AT&T already is highly motivated to promote a retail market and, as explained below, is taking aggressive steps toward that goal.

B. AT&T Has Entered Into Significant Contractual Relationships With Leading Consumer Electronics Manufacturers Which Expressly Provide For The Retail Availability Of Advanced Digital Set-Top Boxes.

AT&T has responded to the foregoing consumer and competitive demands by entering into strategic relationships with leading consumer electronics manufacturers and retailers. Most significantly, over the last several months, AT&T negotiated agreements with Philips and Panasonic to develop advanced digital set-top boxes, and these agreements specifically envision

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[19] *See* Stanley M. Besen and John M. Gale, "A Further Economic Analysis of the Commercial Availability of 'Navigation Devices' Used in Multichannel Video Programming Systems," attached to Reply Comments of General Instrument Corporation in CS Docket No. 97-80, June 23, 1997, at 13-14 ("MVPDs have no incentive to use their ability to offer integrated boxes to prevent consumers from choosing separate boxes. An MVPD sells services for which it collects monthly fees, and it wishes the demand for those services to be as large as possible. Limiting equipment choices to potential subscribers, or raising the price of equipment, is, therefore, not in the interest of the MVPD because that reduces the demand for its service. Because some consumers will prefer the style, design, and capabilities of features-only boxes purchased from sources that are unaffiliated with the MVPD, the MVPD can increase the demand for its services from that set of consumers by offering security-only boxes on attractive terms and, therefore, gain additional subscribers.") ("*Besen and Gale Commercial Availability Economic Analysis")*.

that these boxes will be made available for the retail market.[20] Pursuant to these agreements, equipment manufacturers will develop and manufacture advanced digital set-top boxes that will be leased to customers directly by AT&T as well as through retail outlets, such as kiosks at Best Buy. At the same time, these manufacturers will market these set-tops for sale at retail outlets through their existing and new sales channels. In fact, AT&T's agreements with Philips and Panasonic *place no constraints on their ability to sell these devices to any and all retailers for their resale to consumers*. AT&T anticipates that over time these devices will be increasingly sold to new and existing customers at retail, rather than leased directly from AT&T.

The Philips and Panasonic digital set-top boxes described above are all "integrated devices" in that they incorporate the same embedded conditional access technology used in the integrated set-tops that AT&T offers for lease to its customers.[21] They will also include the following state-of-the-art technology: a DOCSIS modem for high-speed cable Internet service; multiple tuners; 32-48 MB of RAM; a graphics chip; multiple ports, including a 1394 connector for home networking; an ISO-7816 smart card slot used in connection with e-commerce applications such as home banking; an IDE controller; and a POD slot that can be used in the

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[20] AT&T is currently negotiating with other consumer electronics equipment manufacturers, as well, to produce advanced digital set-top boxes.

[21] AT&T recognizes that in an earlier phase of this proceeding the cable industry raised concerns about offering integrated set-top boxes with embedded security at retail. In particular, cable operators highlighted the fact that the analog conditional access technology then prevalent in the industry was vulnerable to piracy, and that making integrated devices available at retail therefore presented an unacceptable risk of signal theft. *See, e.g.*, NCTA Comments, filed in CS Docket No. 97-80, at 10 (May 16, 1997) (noting security risks); U S West Comments, filed in CS Docket No. 97-80, at 3-8 (May 16, 1997) (noting that the high potential for theft of service made the commercial availability of analog boxes untenable). However, digital technology has enabled the industry to develop more secure encryption methods such that retail deployment of integrated digital devices is now a viable option. Moreover, as noted, the integrated devices

(footnote continued ...)

event the embedded security system is compromised. The POD slot also makes the devices portable to non-AT&T cable systems.[22] In short, these devices will provide consumers with a vast array of advanced and innovative interactive television services, such as e-mail, chat, address book, calendar, video-on-demand, personal video recording, e-commerce, and Internet access functions.

AT&T highlights below key aspects of the agreements:[23]

- **Philips**. AT&T contracted with Philips in mid-August to deliver one million advanced integrated digital set-tops, beginning in 2001.[24] The Philips boxes will house Philips' PNX 8500 Nexperia Home Entertainment Engine, which combines media processing and CPU processing. That software-processing platform is capable of providing two-way applications, such as interactive television, video-on-demand, MP3 downloads, streaming video, personal video recording, advanced electronic program guides, shopping, video electronic mail, high-speed Internet access, gaming, and IP telephony.[25] The technology also leaves 50% or more processing power for future upgrades.

- **Panasonic**. The Panasonic agreement, executed in late September, will entail the delivery of one million integrated digital set-top boxes over a three-year period beginning next summer.[26] Panasonic will produce boxes for retail that will be differentiated by services offered and price. For example, one box might be geared for Web surfing and interactive TV, while a second box, with personal-

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(... footnote continued)

AT&T will make available at retail will include a POD interface for backup security, further attenuating concerns about retail distribution of integrated set-top boxes.

[22] AT&T emphasizes that going-forward all integrated digital set-top boxes it purchases for deployment on AT&T's cable systems will be equipped with a POD interface.

[23] The press releases describing AT&T's agreements with Philips and Panasonic are attached in Exhibit A.

[24] *See* Baumgartner, *AT&T Books Philips Order, Breaks Digital-Box Ranks*, at 37-38 (highlighting aspects of agreement).

[25] *See* Matt Stump, *Philips Chip Unit Debuts Multiple-Service Silicon*, Multichannel News, Oct. 9, 2000, at 41-42.

[26] *See* Stump, *AT&T Box Deals Eye Retail*, at 1, 66 (describing elements of agreement).

> video recording and HDTV capability, may be more video-centric. Panasonic also plans to develop peripheral equipment, such as IP phones, faxes, video cameras, Web phones, and digital still cameras for home conferencing.[27]

AT&T has selected Philips and Panasonic as new equipment partners because of the strong consumer brands both companies possess and because of their significant knowledge, expertise, and presence *in the retail arena*. For example, AT&T Broadband's chief technology officer has stated that "Philips continues to demonstrate a superb ability to innovate in consumer electronics equipment," adding that this "innovation, combined with Philips's knowledge of retail distribution channels, will be beneficial as we start to move into retail distribution."[28] Likewise, AT&T Broadband's senior vice president and chief procurement officer said that "Panasonic's strong brand and experience in retail, combined with a history of quality and innovation, makes the company a powerful associate as we move into the retail space."[29] AT&T also notes that it has worked with Motorola to ensure that *Motorola will license critical DES encryption and other core security technologies to Philips, Panasonic, and future consumer electronics vendors to ensure that such equipment vendors will be able easily to produce and make available for retail distribution full-function, integrated set-top boxes that work seamlessly*

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[27] AT&T notes that it is also currently working with Motorola to develop a similar POD-equipped advanced integrated digital set-top box for the retail market. *See Motorola Announces Comprehensive Video, Voice, and Data Supply Arrangement With AT&T Broadband*, AT&T News Release (Aug. 14, 2000) (noting that AT&T plans to work with Motorola on retail distribution strategies for set-top boxes and cable modems). AT&T has already ordered DCT-2020 host set-top boxes from Motorola, which are equipped with a POD interface, and notes that Motorola is developing a version of its DCT-5000 advanced, integrated digital set-top box that is equivalent to the POD-equipped, retail-ready boxes from Philips and Panasonic described above.

[28] *AT&T Broadband Selects Philips Electronics For Advanced Digital Cable Set-Top Terminals*, AT&T News Release (Aug. 14, 2000).

[29] *Panasonic Announces Alliance With AT&T Broadband To Drive Advanced Cable Set-Top Terminals In Retail Marketplace*, AT&T News Release (Sept. 26, 2000).

on AT&T's systems.[30] In short, there will be interbrand competition among AT&T's equipment suppliers, which, of course, will ultimately benefit consumers in terms of lower prices, more choice, and greater navigation device functionality.

What these agreements underscore is plain: There is no need for the Commission to accelerate the ban on integrated devices or to adopt any other extraordinary measures to micromanage the development of a retail market. AT&T already has taken concrete and meaningful steps to create a vibrant retail market and the progress toward that goal is inexorable.[31]

C. AT&T Has Also Negotiated A Deal With Best Buy To Market And Sell Digital Services And Equipment, Including Digital Set-Top Boxes, And Is Working To Execute Similar Agreements With Circuit City And Other Leading Retailers.

AT&T's retail strategy also includes establishing relationships with leading national retailers much like those that DBS has pursued. In the first of what AT&T expects will be many such alliances, AT&T recently announced a non-exclusive agreement with Best Buy to sell

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[30] *See* Baumgartner, *AT&T Books Philips Order, Breaks Digital-Box Ranks*, at 37-38 ("To support retail requirements, the boxes Philips will supply to AT&T Broadband will accept OpenCable-compliant point-of-deployment modules based on the Motorola-General Instrument Corp. DES (Data Encryption System), a conditional-access platform that AT&T Broadband has deployed in a majority of its systems."); Stump, *AT&T Box Deals Eye Retail*, at 1, 66 (noting that Panasonic boxes will "be manufactured to the Motorola DES (Data Encryption System) specification").

[31] AT&T notes that other cable operators are also starting to take steps toward pursuing a retail strategy for digital set-top boxes. *See, e.g.*, Martin Levine, *Eager To Find Second Sources, MSOs Tap CE Bigs For Boxes*, Multichannel News, July 24, 2000, at 59 (noting that "the eventual shift to retail distribution is believed to be largely responsible for a contract Time Warner signed with Panasonic in April to deliver at least 600,000 'Pegasus' digital set-tops over the next three years"); *id.* (noting that decisions by cable operators to partner with mainstream consumer electronics manufacturers for digital set-top boxes -- including Comcast's contract with Pace and Cablevision's contract with Sony -- reflect in part "belief that brand-name vendors will become increasingly important as a portion of digital-box distribution shifts from leasing to a retail-based consumer-sales model").

AT&T's broadband services, such as digital cable television and high-speed cable Internet service, at Best Buy's retail stores.[32] Best Buy plans to set up AT&T-branded interactive kiosks in markets where AT&T offers digital services. As part of this effort, Best Buy will promote -- initially for lease from AT&T but eventually for sale directly from Best Buy -- digital cable set-top boxes to prospective customers. The two companies also plan to work together with consumer electronics manufacturers to encourage the creation of broadband digital appliances with new functions.[33] According to AT&T Broadband's vice president of sales and distribution, "[AT&T's] alliance with Best Buy makes it easier to shop for broadband products and services by giving consumers an opportunity to see how the services actually work. They'll be able to make purchasing decisions that make the most sense for them and their particular needs."[34] As one cable industry analyst said of this relationship:

> This alliance [between AT&T and Best Buy] will bring broadband into the mainstream. Customers will be able to buy brand-name broadband services from a brand-name retailer. That's a powerful combination, and a natural extension of the evolution occurring in the industry today -- the retailing of services.[35]

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[32] *See* Hogan, *AT&T Taps Best Buy As Retail Partner*, at 3, 90 (describing key aspects of agreement). AT&T and Best Buy previously worked together to test retail sales of AT&T Broadband's high-speed cable-modem service in several markets as well as digital cable in Pittsburgh. *See AT&T Partners with Best Buy*, Multichannel News Online, Oct. 12, 2000, *at* http://www.multichannel.com/daily/26d/shtml.

[33] *See Best Buy To Sell AT&T Broadband Services*, Reuters, Oct. 11, 2000.

[34] *Best Buy and AT&T Broadband to Form Retail Alliance*, Best Buy News Release, Oct. 11, 2000. *See* Exhibit B for a copy of this press release. AT&T is working with Best Buy to develop appropriate compensation arrangements for the marketing and sale of digital products and services.

[35] *Best Buy and AT&T Broadband to Form Retail Alliance*, Best Buy News Release (quoting cable industry analyst Jeff Kagan).

AT&T is pursuing similar agreements with other retailers, including Circuit City, and has already initiated a number of retail marketing trials for its digital cable service and equipment in several locations. In fact, earlier this month, AT&T launched a three-month trial program for digital cable service in four Circuit City stores in Portland, Oregon. Under the program, AT&T has set up a promotional space in each Circuit City store so that customers can view the digital cable service. If they are interested in subscribing, customers can purchase a digital service kit at the store, which includes discount coupons and other promotional items. Customers can then subscribe to the service by calling AT&T Broadband from phones in the store or from home. AT&T has launched a similar trial with Best Buy in Dallas, Texas. In these trials, AT&T will lease the set-top box to the customer separately but, again, AT&T intends that the equipment ultimately would be available for purchase by the consumer from the retailer. Indeed, AT&T has an ongoing trial with Circuit City in Richmond, Virginia under which Circuit City actually sells directly to consumers Motorola's DCT 2000 integrated set-top box for use on AT&T's cable systems.

In partnering with major retailers, AT&T is aiming to build upon the initial success it has enjoyed in marketing cable modems and cable modem service at retail.[36] For example, AT&T is selling cable modem service in 58 Circuit City stores and 22 CompUSA stores in areas of the country where Excite@Home is available, and launched with Best Buy in three markets at the

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[36] *See* Monica Hogan, *MSOs Tread Carefully Into Retail World*, Multichannel News, May 1, 2000, at 116 (describing retail efforts of AT&T MSOs). Other cable operators are pursuing similar retail strategies as well. *See id.* at 116-120 (noting, for example, that Cox is distributing its Excite@Home product through retailers such as CompUSA and Circuit City, and that Cablevision is selling digital services through The Wiz).

end of October.[37] Likewise, the former MediaOne cable systems launched cable modem service with 17 Circuit City locations in the Boston area, and also brought the service to Circuit City stores in Atlanta, Georgia and Richmond, Virginia, as well as RadioShack stores in Jacksonville, Florida. In fact, 15% of AT&T's data sales in the New England market are coming through retail. It is also important to note that Excite@Home recently announced an agreement to sell its service in RadioShack stores around the country, including areas served by AT&T cable systems.[38]

The *Notice* asks why cable modems have been made available at retail whereas set-top boxes have not.[39] There are at least three explanations. First, consumers have historically purchased telephone modems along with personal computers at retail, so the model was well-established and it was relatively easy for cable operators to replicate. Second, cable modems are much simpler devices than advanced cable set-top boxes, so, again, they could be integrated more seamlessly into the traditional retail chain. And third, the DOCSIS process has been underway since 1996, and specifications for cable modems were adopted as an international standard in early 1998, so vendors have had a number of years to bring cable modems to

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[37] AT&T is selling cable modem service in 23 Best Buy stores as of November 6, 2000. *See Broadband Service Offerings*, Best Buy News Release, Nov. 6, 2000, *at* http://64.45.49.154/bbyvpr/nr20001106-2.asp.

[38] *See Excite@Home Lands RadioShack* Deal, Multichannel News Online, Oct. 20, 2000, *at* http://www.multichannel.com/daily/37d.shtml (noting announcement of strategic alliance designed to speed consumer adoption of broadband Internet access over cable). *See also Excite@Home And RadioShack Announce Strategic Alliance To Accelerate Adoption Of Cable Broadband Service*, RadioShack News Release, Oct. 19, 2000 (quoting AT&T Broadband's senior vice president of marketing and sales as saying: "We believe wide retail availability of our products and services will be increasingly important.").

[39] *See Notice* at ¶ 12 ("In contrast, we note that a retail market for cable modems is developing in certain regions of the country. We seek comment on this apparent disparity.").

market.[40] In contrast, the OpenCable specifications were published in late 1999, interoperability testing began early this year, and OpenCable compatible PODs were deployed, consistent with the Commission's rules, only a few months ago.[41] Thus, at the very least, it will take additional time, as it did with cable modems, to establish a retail presence for these devices.[42] Nevertheless, because a retail presence is of critical competitive importance, AT&T is doing all it can to accelerate this process.

D. AT&T Has Also Been A Leading Participant In The CableLabs/OpenCable Effort.

AT&T has also helped to promote the retail availability of cable set-top boxes through its active involvement in CableLabs and the OpenCable initiative. In fact, AT&T committed ten engineers full-time to help develop the POD/host specifications, and has spent millions of dollars on the OpenCable effort, including annual recurring costs to upgrade cable headends and the National Authorization Services ("NAS") -- a HITS platform offering cable operators a simple and economical means of authorizing set-top boxes to receive pay-per-view movies and events, premium services, and other programming services -- to make them compatible with OpenCable POD and host devices.

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[40] *See* CableLabs, *A Decade of Innovation: The History of CableLabs, 1988-1998*, at 48-52 (1998) (describing history of DOCSIS initiative). *See also ITU Approves A Standard For Transmission Systems For Interactive Cable Television Systems*, International Telecommunications Union Press Release, April 16, 1998 (announcing adoption of J.112 standard).

[41] *See July 2000 Status Report* at 10-12.

[42] Moreover, as with the cable modem experience, it will take time for cable operators and retailers to harmonize their efforts in selling digital set-top boxes at retail because of differences in the traditional business models for cable and retail electronics. Cable is a locally-based, highly-decentralized business, whereas retailers market their products and services nationally. Consequently, cable operators and retailers will have to work through marketing, operational, and other business issues to deliver digital cable equipment and services on a national scale.

As AT&T and other members of the cable industry have reported to the Commission, CableLabs successfully implemented the digital separate security requirement which permitted cable operators to take delivery of digital POD modules by the Commission's July 1, 2000, deadline.[43] Notwithstanding the allegations of some retailers, the POD/host specifications establish an architecture and platform to deploy advanced services, and, therefore, will allow for the production of host set-top boxes with features comparable to those currently available from cable operator-provided boxes.[44] Moreover, OpenCable is currently going beyond what the statute and the Commission's rules require by working diligently on the development of "middleware," a complex software integration project that will further enhance the portability of OpenCable-compliant host devices.[45]

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[43] *See* Status Report, filed in CS Docket No. 97-80, at 8-9 (July 7, 2000) ("July 2000 Status Report") (noting that cable operators met the Commission's July 1, 2000 deadline to have digital separate security modules available for customers who obtain digital "host" set-top boxes at retail stores).

[44] *See id.* at 12-13 (noting that boxes built to the OpenCable bi-directional specifications will indeed be a platform comparable to the bi-directional boxes cable operators deploy). Additional functionality can be deployed through software upgrades to the host. *See id.* at 13.

[45] Such portability is not required by the commercial availability rules. *See In the Matter of Implementation of Section 304 of the Telecommunications Act of 1996: Commercial Availability of Navigation Devices*, Rept. & Order, 13 FCC Rcd. 14775, at ¶ 126 (1998) ("*Commercial Availability Order*") ("[W]e have not adopted specific rules to mandate portability or interoperability."); *In the Matter of Implementation of Section 304 of the Telecommunications Act of 1996: Commercial Availability of Navigation Devices*, Order on Reconsideration, 14 FCC Rcd. 7596, at ¶ 48 (1999) ("*Commercial Availability Reconsideration Order*") ("The Commission did not mandate that navigation devices be portable or interoperable."). AT&T appreciates the promise of the middleware initiative, and is lending strong support to the effort. However, it wishes to underscore the significant level of complexity associated with the development of middleware specifications. CableLabs is working with numerous participants from the information technology, software, consumer electronics, retail, and cable industries in this effort, and it will clearly take time to develop, finalize, test, and standardize middleware specifications, as well as the ports that will allow applications such as electronic program guides and video on demand, to run on the middleware.

In sum, as the foregoing discussion demonstrates, AT&T and the cable industry have been aggressively investing in and pursuing the development of a retail strategy for digital set-top boxes, cable modems, and other navigation devices. The Commission should be encouraged by these pro-competitive and pro-consumer developments and allow them to continue to flourish by avoiding any further regulation in this area.

III. THE COMMISSION SHOULD ELIMINATE THE BAN ON INTEGRATED CABLE SET-TOP BOXES OR, AT THE VERY LEAST, CLARIFY THAT INTEGRATED SET-TOP BOXES THAT ARE AVAILABLE AT RETAIL ARE NOT SUBJECT TO THE BAN.

The *Notice* invites comment on "whether it would be satisfactory to permit MVPD or retail distribution of integrated boxes after January 1, 2005 if integrated boxes are also commercially available or for other reasons necessary to further the objectives of Section 629."[46] AT&T believes there are compelling reasons to eliminate the ban on integrated boxes. At the very least, the Commission should conclude that integrated devices that are available for purchase by consumers at retail are not subject to the ban. Moreover, the Commission should clarify that the exemption in Section 1204(a)(2) of the commercial availability rules applies where integrated cable set-top boxes that also include a POD interface are offered at retail for sale to consumers.

A. The Commission Should Revisit The Ban On Cable Operator Sale Of Set-Top Boxes With Embedded Security, At Least With Respect To Integrated Set-Top Boxes That Are Available For Purchase At Retail.

There are compelling reasons why the Commission should consider eliminating the ban on integrated set-top boxes as part of this proceeding. First, the integration ban will harm consumers by denying them access to a cost-effective product choice. The separation

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46 *Notice* at ¶ 11.

requirement will result in higher costs to consumers for navigation devices. The separate security mandate requires not only the creation of an entirely new interface that is not needed with integrated devices, but also the design and implementation of engineering solutions for *both* sides of this interface as opposed to a *single* set of solutions for an integrated device. For example, inclusion of separate encryption/decryption and copy protection functionality in both the POD and host is necessary to ensure that encrypted programming is secure as it passes across the POD-host interface. The POD and host also require their own separate central processing units and separate power supplies. There are also new connectors and other duplicative components that are not required when everything is housed in a single unit with embedded security. These additional design and component requirements will mean that a POD/host combination is approximately $75 to $90 more expensive than an integrated device performing the same functions.[47]

To the extent an integrated device offers a better combination of price, quality, and functionality to particular consumers, the effect of the ban is thus directly contrary to the intent of Section 629. In fact, the D.C. Circuit noted in its recent decision on the commercial availability rules that consumers might choose not to purchase devices at retail for "perfectly sensible economic reasons," such as lower cost, and that if this were the case, "the integration

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[47] *See, e.g.*, Comments/Opposition of General Instrument Corporation in Response to Petitions for Reconsideration, filed in CS Docket No. 97-80, at n. 42 (Sept. 23, 1998) ("GI's own internal estimates indicate that even employing the most conservative assumptions, application of the ban to integrated digital devices is likely to result in the imposition of at least $75 in additional equipment costs per customer."). AT&T's own experience is that the POD currently costs approximately $78 and the POD interface costs $10-15, for a total additional cost of between $88 and $93. This additional cost only applies where a customer needs <u>both</u> a POD and host device to receive cable service. In contrast, inclusion of a POD interface in AT&T's integrated boxes will add only slightly to the cost of such boxes. AT&T believes this added cost is justified given the enhanced portability the POD interface facilitates.

ban does nothing more than deny the most cost-effective product choice to consumers -- an ironic outcome for an order implementing 'one of the most pro-consumer, pro-competitive provisions of the Telecom Act.'"[48] Commissioner Powell made a similar point in his partial dissent to the Commission's *Commercial Availability Reconsideration Order*, observing that:

> [It is] contrary to good public policy to remove from the market one potentially cost-effective choice for consumers. It would be more practical to allow operators to deploy integrated boxes that may well be less costly and provide greater security for the system. The benefits of allowing operators to use such equipment would redound to consumers, giving them more equipment options at potentially lower prices.[49]

In sum, because consumers have choices, the Commission should rely on the marketplace to determine the success or failure of particular devices and should not eliminate a cost-effective alternative that certain consumers may prefer.[50]

Second, the success of the OpenCable initiative further justifies eliminating the integration ban. As noted above, OpenCable has developed standardized specifications for the manufacture of POD and host devices (that provide functionality comparable to existing

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[48] *General Instrument Corp. v. FCC*, 213 F.3d 724, 731-32 (D.C. Cir. 2000) (quoting statement of Commissioner Ness). Commissioner Powell suggested in his dissent to the initial commercial availability order other possible reasons why a consumer may opt against buying a host device at retail, including the inconvenience of having to purchase a set-top box at retail and lease a POD from the cable operator, or the risk of buying a box in the face of rapidly changing technology. *See Commercial Availability Order* at 14848 (Statement of Commissioner Powell).

[49] *Commercial Availability Reconsideration Order*, at 7632 (Statement of Commissioner Powell). *See also Commercial Availability Order* at 14848 (Statement of Commissioner Powell) ("I fear that the majority decision today denies a cost effective choice for consumers. It is quite plausible to me that the 'impediment' to switching to retail may in fact be a consumer preference for distributor-supplied boxes! I see no reason to attempt to control consumer preferences.").

[50] *See Commercial Availability Reconsideration Order* at 14848 (Statement of Commissioner Powell) ("We talk so glowingly about letting consumers make choices in free markets, but, time and again, we cannot quite bring ourselves to trust either those consumers or the market.").

operator-leased integrated devices) in compliance with the Commission's rules, and is now going beyond those requirements in crafting middleware specifications that will enhance the portability of host devices.[51]

At the very least, the Commission should make clear that the integration ban does not apply to any integrated set-top box that is also available for consumer purchase from retailers. As an initial matter, the availability of integrated boxes at retail would achieve Congress' objective in enacting Section 629 of the Communications Act, namely assuring the commercial availability of navigation devices.[52] Moreover, to the extent AT&T and other cable operators are now pursuing a retail sale option for integrated digital set-top boxes, the underlying rationale for the integration ban collapses with respect to such boxes. The Commission's primary basis for adopting the integration ban was the concern that allowing MVPDs, particularly cable operators, to continue to serve as the *exclusive* providers of integrated devices would give them an unfair advantage over retailers and would thereby "interfere with the statutory mandate of commercial availability."[53] If such integrated cable set-top boxes are also available to consumers through independent retail outlets, there is no longer a basis for banning them.[54]

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[51] *See* Leslie Ellis, *Middleware: Over the OS, Under the Apps*, Multichannel News, Oct. 2, 2000, at 54 (describing benefits of middleware).

[52] *See* 47 U.S.C. § 549(a) (directing the Commission to promulgate rules to "assure the commercial availability" of navigation devices). *See also* H.R. Rept. No. 104-204, Part I, at 112 (1995) ("The Committee intends that the rules adopted by the Commission pursuant to Section 203 will assure consumers of the availability of navigation devices and other customer premises equipment from a variety of sources during the transition period to a competitive market for such devices.").

[53] *Commercial Availability Order* at ¶ 69. The Commission's *Order* specifically notes Circuit City's argument that "*service providers* . . . should not be permitted to lease their own bundled (*i.e.*, integrated) devices because this would give them an effective cost advantage." *Id.* at ¶¶ 68-69 (emphasis added). *See also Commercial Availability Reconsideration Order* at ¶ 30 ("Allowing *MVPDs* the advantage of being the *only* entity offering bundled [*i.e.*, integrated]

(footnote continued ...)

B. The Commission Should Also Clarify That The Exemption In Section 1204(a)(2) Of The Commercial Availability Rules Applies Where Integrated Cable Set-Top Boxes That Also Include A POD Interface Are Made Available At Retail.

The Philips and Panasonic integrated digital set-top boxes described above not only will be available for consumers to purchase at retail stores across the nation, but also will contain a POD interface designed to provide a "back up" security mechanism (through the connection of a POD module) and enhanced portability. As AT&T demonstrated in the previous section, there is no legal or public policy basis for prohibiting cable operators from making integrated devices available to their customers, even after the 2005 deadline, so long as such integrated devices are also available for purchase by consumers from retailers. This conclusion is even more compelling with respect to the POD-equipped integrated devices AT&T intends to deploy.

In particular, the Commission should clarify that the exemption in Section 1204(a)(2) of the commercial availability rules applies where POD-equipped integrated devices are made available at retail. Section 1204(a)(2) provides that the integration ban will not apply to any MVPD supporting integrated devices that: (1) operate throughout the continental U.S.; and (2) are available from retail outlets and other vendors throughout the U.S. that are unaffiliated

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(... footnote continued)

boxes could adversely affect the development of this equipment market.") (emphasis added). Moreover, the Commission accepted CEA's assertion at the time -- then supported by the NCTA and the cable industry -- that "it is highly improbable that devices with embedded security functionality could be made available from any source other than the cable operator." *Commercial Availability Order* at ¶ 68. As noted above, digital encryption technology has advanced to the point where AT&T believes it is sufficiently secure to justify consumer purchase and ownership of integrated digital set-top boxes at retail. *See* n. 21, *supra*.

[54] As noted, AT&T is experimenting with selling DCT-2000 set-top boxes at retail in Richmond, Virginia, and AT&T foresees similar retail sale opportunities going forward. AT&T believes that consumers should not be deprived of the option of buying such devices at retail, particularly as the price for the DCT-2000 or similar integrated set-top boxes declines and the retail market becomes a more viable distribution channel.

with the MVPD.[55] The Commission concluded in its original *Commercial Availability Order* that DBS (and C-Band) providers met this standard and were therefore exempt from the separation requirement and integration ban because their equipment was already "available at retail," offering consumers competitive benefits such as greater consumer choice, lower equipment prices, and enhanced options and features.[56] While the Commission has only had the occasion to consider the exemption for DBS and C-Band, the language in Section 1204(a)(2) is not industry specific. Rather, the exemption applies to *any* qualifying MVPD.[57]

The requirements of the exemption are satisfied where the Philips and Panasonic integrated boxes discussed above are offered at retail. These boxes will be fully functional on any AT&T cable system nationwide and will also, with the use of a POD, permit customers to receive all of the core digital video services from *non-AT&T* cable systems.[58] Therefore, the first prong of the exemption is satisfied since the devices would "operate throughout the continental United States." To the extent such POD-equipped integrated devices are also available

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55 *See* 47 C.F.R. § 76.1204(a)(2).

56 *Commercial Availability Order* at ¶ 64.

57 *See* 47 C.F.R. § 76.1204(a)(2) ("The [separation requirement] shall not apply to a *multichannel video programming distributor* that supports the active use by subscribers of navigation devices that: (i) operate throughout the continental United States, and (ii) are available from retail outlets and other vendors throughout the United States that are not affiliated with the owner or operator of the multichannel video programming system.") (emphasis added). Moreover, in concluding that integrated devices used by cable operators were not portable, the Commission left open the possibility that future cable devices might offer sufficient portability to satisfy this prong of the exception. *See Commercial Availability Order* at ¶ 66 (stating that "other MVPD services, such as cable, *currently* do not offer geographic portability") (emphasis added).

58 By contrast, AT&T notes that a DirecTV integrated receiver will not work in the EchoStar system *at all*, and vice versa.

throughout the United States from retail outlets that are unaffiliated with the MVPD, the second prong of the test is also met.

IV. AT A MINIMUM, THE COMMISSION SHOULD NOT ACCELERATE THE BAN ON INTEGRATED DEVICES BECAUSE SUCH ACTION IS NOT NECESSARY TO PROMOTE THE COMMERCIAL AVAILABILITY OF NAVIGATION DEVICES AND WOULD OTHERWISE HARM CONSUMERS.

AT&T strongly opposes any effort to accelerate the phase-out date. Accelerating the date is unnecessary because the retail market for navigation devices is in fact developing, as the OpenCable efforts and AT&T's (and other MSOs') relationships with consumer electronics manufacturers and retailers demonstrate. Moreover, taking such an action would significantly disrupt AT&T's design, procurement, and deployment plans for set-top boxes and harm consumers by limiting their product choices and substantially delaying or eliminating the development and rollout of advanced innovative services.

A. Accelerating The Ban Is Unnecessary To The Development Of A Retail Market For Advanced Digital Set-Top Boxes.

As shown above, the technical foundation is in place and the market is moving toward retail availability of advanced digital set-top boxes. OpenCable has produced specifications that allow for the development of POD and host devices in compliance with the Commission's rules, and is also working with industry leaders on middleware specifications that will enhance the portability of host devices. In short, equipment manufacturers now have the tools to build host devices with features comparable to those currently available from cable operator-provided boxes.[59] Moreover, AT&T is aggressively pursuing a retail strategy for advanced, digital set-top boxes and it expects other MSOs to follow suit. The retail market for navigation devices is

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[59] *See July 2000 Status Report* at 11 & n. 11.

developing in an appropriate manner, and the Commission should therefore refrain from accelerating the phase-out date.

Furthermore, even assuming *arguendo* that cable operators enjoy a competitive advantage from leasing integrated devices -- a highly dubious proposition going-forward in light of cable's competitive need for a retail presence -- such an advantage can be offset by the integrated product and service offerings of consumer electronics manufacturers and retailers. For example, consumer electronics manufacturers have announced plans to develop products which integrate host navigation device functions in other consumer electronics equipment, such as television receivers, DVDs, and VCRs.[60] In addition, retailers have the opportunity to further enhance the commercial viability of their product offerings through other means, including joint marketing arrangements or bundled pricing.[61] Some consumers may prefer the price/feature mix available in a cable operator-provided set-top box, but others may prefer the particular features and promotional arrangements offered by consumer electronics manufacturers and retailers. So long as consumers have the ability to choose, the Commission should trust the marketplace to

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[60] *See, e.g.*, CEA Comments, filed in PP Docket No. 00-67, at 11-12 (May 24, 2000) (noting development of two-way digital television receivers); *Microsoft, Philips Semiconductor and SCM Microsystems Team to Support OpenCable*, Microsoft Press Release, Dec. 14, 1999 (noting demonstration of OpenCable receiver for the PC that provides for premium cable service on the PC). *See also* Letter of Robert S. Schwartz to Magalie Roman Salas, Secretary, FCC, CS Docket No. 97-80, April 2, 1998 (asserting that "Circuit City wants the right to offer such 'cable' boxes competitively, but its overall goal is to be able to offer navigation functionality to consumers, in CE and computer devices, in whatever physical form the marketplace demands [such as TVs, VCRs, computer products, and DVD players]."). *See also DirecTV Enters VOD*, Consumer Electronics, Oct. 30, 2000 (noting that DirecTV will incorporate PVR technology into its set-top boxes).

[61] Best Buy, for example, offers a free DVD player with the purchase of certain digital-ready projection television sets. *See Turn on the Fun*, Best Buy Advertisement Flyer, Oct. 22, 2000. Circuit City is making a similar offer as well. *See Circuit City, Imagine That*, Circuit City Advertisement Flyer, Oct. 22, 2000.

sort out the winners and losers.[62] Finally, as explained above, to the extent retailers will themselves soon be able to provide integrated set-top boxes, any integration advantage cable operators purportedly have would be eliminated.

B. Accelerating The Ban Will Force Consumers To Forego Even Sooner The Opportunity To Select Equipment That May Be More Cost-Effective And Better-Suited To Their Particular Needs.

Because cable companies are already committed to development of a competitive retail market for navigation devices, moving up the phase-out date for integrated devices would not benefit competition or consumers, and, in fact, would harm consumers by, in the words of Commissioner Powell, "remov[ing] from the market one potentially cost-effective choice for consumers."[63] As demonstrated above, the efficiencies associated with integrated set-top boxes translate into cost savings of approximately $75 to $90 per device. Consequently, accelerating the effective date of the integration ban will simply, and needlessly, force consumers to forego even sooner the opportunity to select a cost-effective alternative that may better suit their

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[62] *See Besen and Gale Commercial Availability Economic Analysis* at 13-14 ("If separate security boxes are offered, consumers would be free to choose between purchasing an integrated box provided by the MVPD and purchasing a security-only box from the MVPD and a features box from a source that is unaffiliated with the MVPD. Consumers may benefit from such an arrangement if, because of design and manufacturing efficiencies, the integrated box is less expensive than the two separate boxes. However, some consumers may still prefer the combination of the security-only and features-only boxes both because they prefer the set of features offered and because large consumer electronics manufacturers are also likely to offer features-only boxes at attractive prices due to significant design and scale economies (These manufacturers may also be able to reduce their costs by combining non-security components with other equipment, such as personal computers, VCRs, and television receivers.) Consumers through the marketplace, will determine the nature and amount of integration that is best for them, and there is no reason to prevent consumers who prefer integrated boxes provided by the MVPD from having the opportunity to make that choice.").

[63] *Commercial Availability Reconsideration Order* at 7632 (Statement of Commissioner Powell).

particular needs, a result that runs directly counter to the pro-consumer and pro-competitive objectives of the commercial availability statute.[64]

C. Acceleration Of The Ban Would Cause Significant Disruption To Current AT&T Equipment Design, Procurement, And Deployment Plans, And Thereby Substantially Delay Or Derail The Development Of Innovative Services For Consumers.

Moving up the phase-out date for integrated devices also would adversely affect AT&T's retail sale strategy and other equipment plans, which have been formulated on the basis of the current phase-in schedule.[65] Such a result would harm consumers by delaying or derailing the availability of innovative features and services.

While the Commission stated in its *Commercial Availability Reconsideration Order* that it intended to review the phase-out date for integrated equipment, it also made clear that the "January 1, 2005 date was chosen to allow an MVPD to recover its investment in subscriber equipment that has been placed in service prior to January 1, 2005 and a reasonable period of

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[64] *See General Instrument Corp.*, 213 F.3d at 731-32.

[65] The Commission requests specific information on the equipment deployment plans of cable operators, particularly plans relative to integrated set-top boxes. *See Notice* at ¶ 11. AT&T believes that, based on the foregoing discussion, data on purchase and deployment of integrated boxes alone do not provide a clear picture of the current or future state of the emerging retail market for set-top boxes because some of those boxes will be distributed at retail. For example, AT&T has ordered, and intends to continue ordering over the coming years POD-equipped integrated boxes specifically designed for retail, thus advancing Congress' and the Commission's interest in commercial availability. Similarly, AT&T notes that other cable operators are ordering a growing percentage of their set-top boxes from consumer electronics manufacturers with strong retail brands, indicating that many of these set-top boxes may be targeted for retail distribution. *See, e.g.*, CableFax, Nov. 1, 2000 (citing TechTrends study predicting that consumer electronics vendors, such as Panasonic, Philips, Pioneer, and Sony, will increase their penetration rate for cable set-top boxes from 5% to 25%, and that set-tops from consumer electronics companies will make up 83% of Cablevision's deployments, 42% of Cox's, and 29% of Time Warner's).

time to transition its equipment inventory to unbundled equipment."[66] AT&T has been buying digital set-top boxes to meet the surging demand for digital cable service. It is adding digital video customers at a rate of 4,000 per day, and at the end of September had 2.5 million customers to its digital service, compared to 1.6 million customers a year ago.[67] Accelerating the ban would significantly disrupt AT&T's equipment design, procurement, and deployment plans, and inevitably slow the delivery of new digital services to consumers. This is especially true because the market for host devices is still nascent.[68]

There are other risks as well. Most fundamentally, AT&T is pursuing a design philosophy for integrated, advanced digital set-top boxes based on the 2005 date. As noted, AT&T intends that going-forward all of the advanced digital set-top boxes it purchases for deployment on AT&T's cable systems will be equipped with a POD interface, and that by 2005 all equipment vendors, including those operating under existing supply contracts, will provide POD-equipped boxes to AT&T. AT&T's expectation is that advances in the middleware effort at OpenCable over the next few years will further enhance the portability and functionality of these boxes. Stated another way, AT&T views its retail strategy with respect to fully functional

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66 *Commercial Availability Reconsideration Order* at ¶ 35.

67 *See Third Quarter Reported Earnings Were $0.35 Per Share, Operational Earnings Were $0.38 Per Share*, AT&T Group Earnings Commentary, at 10 (Oct. 25, 2000) (also noting that net additions for the third quarter were approximately 273,000, a 28% increase from approximately 214,000 added in the second quarter). AT&T aims to reach upwards of 3 million digital cable customers by the end of the year, and to eventually penetrate 50% of all of its customers with its new digital-cable package. *See* Steve Donohue, *AT&T Broadband Set for Digital Overhaul*, Multichannel News, May 29, 2000, at 1, 52 (quoting AT&T Broadband's executive vice president of marketing).

68 The Commission has recognized that "the unpredictable pace at which the competitive market will develop makes the prospective inventory requirements of MVPDs difficult to estimate." *Commercial Availability Reconsideration Order* at ¶ 35.

POD-equipped integrated devices and the ongoing OpenCable middleware initiative as symbiotic in that they will both proceed in parallel for several years and eventually dovetail to provide a seamless transition to greater portability and functionality for consumers. Accelerating the integration ban will upend this process, denying consumers the functions, features, and cost-effectiveness of integrated, POD-equipped devices and forcing AT&T to go back to the drawing board with equipment manufacturers and retailers on design and deployment plans for advanced boxes. In short, particularly in light of AT&T's aggressive retail efforts described above, moving up the phase-out date will cause considerable harm to consumers, operators, equipment makers, and retailers alike, without any clear benefits to anyone.

Moreover, to the extent it would entail the stranding of investment on AT&T's set-top box inventory, accelerating the ban would be inconsistent with recent Commission precedent. In particular, the Cable Services Bureau has on two separate occasions agreed not to require cable operators to replace set-top boxes prematurely even though the boxes did not meet certain technical requirements under the Commission's rules.[69] In both instances, the Bureau underscored the importance of "permitting reasonable phase-in periods so that operators and ultimately consumers may not unreasonably be required to pay for replacing equipment in place prior to the end of its useful life."[70] The very same concerns are involved in the timing of the integration ban. In fact, Commissioner Powell expressed such concerns in his partial dissent to the *Commercial Availability Reconsideration Order*, noting that

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[69] *See GCI Cable, Inc.*, Mem. Opin. & Order, CSR-5442-Z, DA 00-1361 (rel. June 21, 2000) (Cable Services Bureau); *Media General Cable of Fairfax County, Inc.*, Mem. Opin. & Order, CSR-5343-Z, DA 99-1240 (rel. June 25, 2000) (Cable Services Bureau).

[70] *See GCI Cable Inc.* at ¶ 7 (citing relevant legislative history accompanying the 1992 Cable Act); *Media General Cable of Fairfax County, Inc.* at ¶ 6 (same).

> the ban is likely to skew present business decisions of operators about when they should buy new set-top boxes, how many they should buy and what plans they should make for deploying digital technology. MVPDs . . . will be forced to make these decisions so as to avoid the potential for stranded investment, not on the basis of what might be best for their customers.[71]

Of course, AT&T and other MSOs have already made equipment decisions based on the 2005 phase-out date, so the risk of "stranded investment" would be even more acute if the Commission were to accelerate this effective date.

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[71] *Commercial Availability Reconsideration Order* at 7632 (Statement of Commissioner Powell).

V. CONCLUSION

For the foregoing reasons, AT&T respectfully urges the Commission to adopt an order in this proceeding that is consistent with the comments herein.

Respectfully submitted,

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November 15, 2000

EXHIBIT A

News Release

FOR RELEASE TUESDAY, SEPTEMBER 26, 2000

Panasonic Announces Alliance With AT&T Broadband To Drive Advanced Digital Cable Set-Top Boxes In Retail Marketplace

SECAUCUS, N.J., and Englewood, Colo. - Matsushita Electric Corporation of America, best known by its Panasonic brand name, today announced a joint initiative with AT&T Broadband to provide about one million advanced digital set-top boxes to AT&T's cable customers during the next three years.

Through this alliance, the companies expect to expand the competitive retail marketplace for advanced digital cable set-top boxes, in turn increasing new services and choices for consumers, and stimulating the introduction of new broadband video, voice and data services via cable set-tops.

"Panasonic is pleased to provide AT&T with our branded set-top boxes, offering AT&T Broadband consumers reliable connectivity to new and exciting forms of multi-media entertainment," said Dr. Paul Liao, chief technology officer, Matsushita Electric Corporation of America. "This relationship ensures that Panasonic's and AT&T's vision for creating an open and competitive environment in the retail marketplace are aligned with the key trends and standards for digital cable and broadband."

"We are pleased that Panasonic will join us in our continuing effort to meet the need for digital video delivery," said Chuck Schultz, senior vice president and chief procurement officer AT&T Broadband. "Panasonic's strong brand and experience in retail, combined with a history of quality and innovation, makes the company a powerful associate as we move into the retail space."

The digital set-top boxes Panasonic will supply to AT&T will feature built-in DOCSIS modems and will accept an OpenCable™ compliant point-of-deployment (POD) module. OpenCable™ is a Cable Television Laboratories, Inc. (CableLabs(t) initiative aimed at developing a new generation of set-top boxes that are interoperable with the legacy of proprietary systems already deployed in the United States. This feature enables separable security, a key requirement for portability. Such portability is important to consumers, as it is intended to allow them to use their set-top box even if they move to a new home. The advanced set-top box also will include a built-in high-speed cable modem, which will enhance the interoperability of the set-top box and enable such services as Web-browsing, e-mail and interactive shopping and banking. For connection to various consumer devices, the Panasonic digital set-top boxes will include an IEEE- 13 94 port.

In addition, Panasonic currently expects to develop peripheral equipment specifically intended to enhance AT&T services at retail. Included among these devices will be IP phones, faxes and video cameras, as well as Web phones, portable EMD devices and digital still cameras for home conferencing. Panasonic also expects to work with AT&T Broadband to integrate a range of products - including DVD, DVD-RAM drives and hard disc drives - into future digital set-top boxes.

Sumitomo Corporation of America's Denver office facilitated the new alliance and supply contract between Panasonic and AT&T Broadband. Panasonic, as part of its commitment to AT&T, plans to open a Denver-based Integration Center where it can interact with AT&T on the development of advanced services for consumers.

About AT&T Broadband

AT&T Broadband, a business unit of AT&T, is the nation's largest broadband services company, providing analog and digital television entertainment services to about 16 million customers across the nation. The company also provides advanced services, such as high-speed cable Internet services and competitive local phone service. AT&T Corp. (NYSE: T) is the world's leader in telecommunications services and technology.

About Panasonic

Panasonic is the best known brand of Secaucus, NJ-based Matsushita Electric Corporation of America, the principal North American subsidiary of Matsushita Electric Industrial Co., Ltd. (NYSE: MC) of Japan. Matsushita Electric is one of the world's leading developers and manufacturers of digital and other electronic products for the home, the office and in between. Additional information on Panasonic and Matsushita can be found at www.panasonic.com.

News Release

Editor's note: AT&T Broadband CTO Tony Werner will be hosting a media Q&A session at 3 PM MT (5 PM ET), 8/14 regarding today's announcement. United States call-in number is 1-800-288-8961, International call-in number is 1-612-332-0923.

FOR RELEASE MONDAY, AUGUST 14, 2000

AT&T Broadband Selects Philips Electronics For Advanced Digital Cable Set-Top Boxes

(Englewood, Colo. & Sunnyvale, Calif) - AT&T Broadband and Philips Electronics (NYSE:PHG) plan to market Philips' advanced digital cable set-top boxes to U.S. consumers beginning in 200 1, the companies said today.

The companies said they are forming a new business alliance with a goal of increasing the competitive retail marketplace for advanced digital cable set-top boxes.

The new retail marketplace will spur competition and innovation among world-class technology suppliers, increase choices for consumers, and stimulate the introduction of new broadband video, voice and data services via cable set-tops. This retail alliance will accelerate the innovation in the marketplace. In addition, AT&T Broadband also expects to purchase set-top boxes directly from Philips. The companies have agreed on an initial volume of one million set-tops.

"We are pleased to have Philips working with us to help us continue to meet the incredible need for digital video delivery," said Tony Werner, chief technology officer for AT&T Broadband. "Philips continues to demonstrate a superb ability to innovate in consumer electronics equipment. This innovation, combined with Philips' knowledge of retail distribution channels, will be beneficial as we start to move into retail distribution."

"Philips is excited to be working with AT&T Broadband to create an open and competitive environment," said Rob.van Oostenbrugge, CEO, Philips Digital Networks. "World-class suppliers now have a clear entry point upon which to develop innovative new technologies. The ultimate beneficiaries of this alliance will be AT&T Broadband customers, who will soon be able to purchase digital cable set-tops just as they do other consumer electronics products, allowing them to select the services that best suit their interests and needs."

The digital set-top boxes that Philips will provide to AT&T Broadband will accept an OpenCableTM compliant point-of-deployment (POD) module. This feature enables separable security, a key requirement for portability. Such portability is important to consumers, as it means that they still will be able to use their set-top box even if they move to a new home. OpenCableTM is a Cable Television Laboratories, Inc. (CableLabs(R) initiative aimed at developing a new generation of set-top boxes that are interoperable with the legacy of proprietary systems already deployed in the United States. The companies have made arrangements to create compatibility with AT&T's existing headends, based upon the Motorola-GI DES conditional access system, a breakthrough accomplishment for the broadband industry.

The Philips open set-top platform is an important step in establishing a new consumer electronics business model, offering several combinations of digital cable, personalized television and

Internet access services. This platform, which will be deployed in high-bandwidth cable networks, could lay the foundation for creating a residential gateway and a whole new category of in-home accessories. The Philips digital set-top boxes will also feature the versatile and high-performance TriMediaa programmable media processor to be integrated with AT&T Broadband's interactive software platform, which together are expected to provide critical technological advantages over conventional digital set-tops. The TriMedia processor is based upon the Nexperia Digital Video Platform (DVP), which incorporates the TriMedia VLIW processor for advanced media processing. This advanced technology will enable broadband cable subscribers to access the most comprehensive menu o f interactive services available. The TriMedia processor, developed by Philips, is a special-purpose microprocessor for the real-time processing of audio, video, graphics and communications data streams. The advanced processor is well suited for high-performance Internet-based applications such as streaming media, e-commerce, gaming, and other two-way interactive services as well as a wide variety of new television entertainment services such as video-on-demand and personal video recording employing an internal hard disk drive.

The Philips set-top platform is intended to be the catalyst for developing a residential gateway and a whole new category of in-home accessories, including speech recognition input devices, wireless speakers and display devices, cameras for teleconferencing, and voice and data communications products. The Home AV networking specification (HAVi) will be used to provide ease-of-use and application interoperability between the Philips set-top box and connected devices.

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Philips Digital Networks -- a business group of the Philips Consumer Electronics division -- is a world-leading provider of advanced digital system solutions for Service and Network providers in broadcasting and video distribution. Philips Digital Networks offers product and service solutions for customers in both the professional side of the distribution chain, as well as for consumers to use in the home. In the consumer domain, Philips Digital Networks is a leading provider of set-top boxes for digital television and internet delivery, as well as personal video recording. A pioneer in the development of Internet-enabling technologies, Philips Digital Networks is playing a key role in the introduction of MPEG4-based media streaming solutions. The broad professional product portfolio includes a comprehensive range of television cameras, studio and compression equipment, conditional access systems and transmission systems for broadband cable networks to deliver a full array of interactive services. A flexible customer support program and active involvement in the bodies setting tomorrow's entertainment and information delivery standards makes Philips a natural partner for the digital broadcast era.

Royal Philips Electronics of the Netherlands is one of the world's biggest electronics companies and Europe's largest, with sales of EUR 31.5 billion in 1999. It is a global leader in color television sets, lighting, electric shavers, color picture tubes for televisions and monitors, and one-chip TV products. Its 232,433 employees in more than 60 countries are active in the areas of lighting, consumer electronics, domestic appliances, components, semiconductors, medical systems, and IT services (Origin). Philips is quoted on the NYSE (symbol: PHG), London,

Frankfurt, Amsterdam and other stock exchanges. News from Philips is located at www.news.philips.com.

Product and company names used herein are trademarks or registered trademarks and are owned by the companies mentioned.

EXHIBIT B

Latest News

Best Buy and AT&T Broadband to Form Retail Alliance Top Electronics Retailer Will Offer Shoppers AT&T Broadband Services

ENGLEWOOD, Colo., and MINNEAPOLIS, October 11, 2000 - Best Buy Co., Inc. (NYSE: BBY) will offer selected AT&T Broadband services at Best Buy retail stores beginning this fall, the companies said today. The A companies signed a letter of intent to form a strategic alliance that will help consumers learn about and buy AT&T Broadband services through interactive kiosks at Best Buy locations within AT&T Broadband service areas around the nation.

Initially, the alliance will allow Best Buy customers to buy AT&T Digital Cable service, featuring more than a hundred channels of television programming; and high-speed cable Internet service, AT&T@Home or AT&T Road Runner, for always-on Internet connectivity.

"AT&T Broadband has spent the past year evaluating how the retail channel can help us reach customers to sell the products and services we offer," said Doug Seserman, senior vice president of Marketing for AT&T Broadband. "Retail will be important, not only as a distribution channel, but also as a source of information that will help us work with consumer electronics manufacturers on innovative products for the future. Ultimately, we envision a wide range of consumer electronics devices available for purchase at retail that will operate on AT&T Broadband's network."

"Best Buy's new relationship with AT&T Broadband allows customers to connect their PC, digital TV or set-top box to broadband or cable services," said Phil Schoonover, Best Buy senior vice president - Digital Technology Solutions. "Best Buy is the leader in providing customers with digital technology products and we will continue to expand our offerings in connections and content. We're pleased to partner in this effort with AT&T Broadband -- a respected and well-known brand."

"Our customers tell us they want more convenient ways to learn about and buy our products," said Dan Hillen, vice president of Sales and Distribution for AT&T Broadband. "The alliance with Best Buy makes it easier to shop for broadband products and services by giving consumers an opportunity to see how the services actually work. They'll be able to make purchasing decisions that make the most sense for them and their particular needs."

"This alliance will bring broadband into the mainstream," said independent industry analyst Jeff Kagan. "Customers will be able to buy brand-name broadband services from a brand-name retailer. That's a powerful combination, and a natural extension of the evolution occurring in the AT&T Broadband and Best Buy also plan to work together, and with consumer electronics manufacturers, to encourage the creation of broadband digital appliances with new functions. The alliance also is intended to include the creation and implementation of e-commerce strategies, joint development of operational systems and synergies, and future business development opportunities.

About Best Buy

Minneapolis-based Best Buy Co., Inc. (NYSE: BBY) is the nation's number one specialty retailer of consumer electronics, personal computers, entertainment software and appliances. The

Company reaches consumers nationwide through its more than 350 retail stores located in 40 states and online at www.bestbuy-com.

About AT&T Broadband

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