programming. *Id.* ¶ 74. The acquisition of monopsony power over suppliers of video programming does not, in any way, reduce the competitive pressures that the MSO experiences at the retail level or the cost/benefit calculations that drive its decisions about which programming to purchase.

To be sure, a cable monopsonist would like to pay as little as possible for this profit-maximizing level of quality programming (as does any purchaser, whether a monopsonist or not). And, as the example above illustrates, all else being equal, the monopsonist might well be able to drive harder bargains for the same bundle of programming. But that is hardly a matter of public or government concern. As explained above, a profit-maximizing monopsonist would not squeeze so hard that the quantity or quality of programming is degraded, and what remains is simply a private negotiation over how the joint surplus created when the programmer agrees to sell programming to the MSO is split between the two contracting parties. The monopsonist may obtain more of the joint surplus than the competitive purchaser, but that has no impact on the quantity, quality or price of programming delivered to consumers – unless, of course, retail competition forces the monopsonist to pass on any additional savings, in which case, the public can only benefit from the exercise of buyer power. Ordover Dec. ¶¶ 72-76.[55] In short, a cable ownership concentration limit could not rationally be based on traditional monopsony concerns.

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[55] Even assuming, counterfactually, that a single cable MSO were the *only* possible buyer of the programming in question, there is no reason to believe that the MSO would be able to necessarily appropriate the entire surplus available. Rather, how the surplus would be divided is a classic bargaining game, the result of which would depend upon the relative strengths and weaknesses of each party's position, including the popularity and uniqueness of the programming and the programmer's ability to deploy its capital in other uses. Ordover Dec. ¶ 76 n.46. And, as detailed below, by growing larger and becoming a "pivotal" buyer, a cable MSO may actually decrease the leverage it enjoys in bargaining with programmers.

2. A Subscriber Limit on Cable Ownership Concentration Could Not Rationally be Based upon Concerns that Cable Companies Might Take Advantage of Sunk Programming Investments to "Hold Up" Video Programmers.

As the Notice (¶ 16) recognizes, the majority of a programmer's costs are fixed and, once those costs are sunk, the programmer's marginal costs of distribution are very low. Economists and regulators have long recognized that when market participants must rely upon large, sunk investments, they are vulnerable to "hold-up." *See* Ordover Dec. ¶ 77; Notice of Proposed Rulemaking, *Matter of Amendment of Section 73.658(g) of the Commission's Rules – The Dual Network Rule*, 15 FCC Rcd. 11253, ¶¶ 12, 13 (2000) ("*Dual Network Rule Notice*"). In economic terms, "hold-up" is the *ex-post* extraction of surplus after sunk investments have been made. Ordover Dec. ¶ 77. In plain English, it is simply the recognition that a seller's negotiating leverage may be significantly reduced if buyers know that the money to develop the seller's product is already spent. In that case, the seller is better off with a very low price than no sale at all, and thus, the seller cannot credibly claim that it will walk away unless the price it receives covers all of the costs of producing the product.

To the extent that programmers are vulnerable to hold-up that cannot be addressed through contractual or other market mechanisms, they may be less likely to enter the market or produce high quality programming. *See Notice* ¶ 29 ("Networks may not have an incentive to enter the market or to be innovative in their programming if they do not anticipate being able to recover the fixed/sunk costs of network program development"). Video programmers and MSOs are, of course, sophisticated entities that know both that programmers are vulnerable to *ex post* exploitation and that cable MSOs need programming. Ordover Dec. ¶ 78. Cable MSOs, collectively, therefore have an incentive to convince programmers that they will not be held-up. *Id.*

There is, however, an additional complication. Each individual cable MSO would like the other MSOs to make the *ex ante* commitments sufficient to induce production of programming of the desired quality. *See* Ordover Dec. ¶ 78. In that way, the "free-riding" MSO could hope to negotiate a better deal with the programmer *after* the programmer's fixed costs are sunk and its marginal costs of an additional sale are very low. *Id.* Absent mechanisms to address such free-riding, there might be under-investment in programming. *Id.* As Professor Ordover explains, sunk cost/free-riding issues are not uncommon in business, and "[t]here is a large body of academic literature that discusses the many mechanisms that can be used to solve such free-riding problems, *e.g.*, contingent and other contractual arrangements made before all of the investment is sunk." Ordover Dec. ¶ 78; *see also Dual Network Rule Notice* ¶¶ 17-18.

For purposes of this proceeding, however, the relevant inquiry is not whether hold-up/free-rider concerns exist with respect to video programming, but whether any such concerns would be exacerbated by increases in cable ownership concentration. And, it is quite clear that, if there is any correlation at all between concentration and hold-up/free-riding, increased concentration actually *reduces* the likelihood of such conduct.

The reason is straightforward. A larger MSO can less credibly threaten to free-ride than a smaller MSO. The larger the MSO, the more it will lose from failure to carry programming consumers value (or from carrying lower quality programs). Ordover Dec. ¶¶ 79-81. And if a buyer gets so large that it becomes "pivotal" to a supplier's production decision – *i.e.*, the supplier cannot economically produce without the buyer's agreement to purchase the supplier's output – it is well-established that the buyer loses altogether "the ability to credibly abdicate responsibility for ensuring that the supplier's costs are covered." Andrew Raskovich, *Pivotal Buyers and Bargaining Position* at 22; *see also* Ordover Dec. ¶¶ 79. Indeed, the *Notice* itself recognizes this point. *See Notice* ¶ 37 ("[t]his problem might be avoided in a single MVPD scenario since the program distributor (*i.e.*, the MVPD) would absorb a greater amount of the sunk costs incurred in the production of new programming (analogous to the "first copy" costs in publishing) in order to ensure the economic viability of essential programmers, and thus the continued supply of high quality programming").

This analysis also explains why the related concern that a "large MSO" may gain an unfair competitive disadvantage against "overbuild entrants due to the large programming license fee discounts the incumbent receives" is unfounded. *Notice* ¶ 30. According to this theory, overbuilders "may be forced to pay programming license fees that are so high that continued operation is unprofitable." *Id.* The theory appears to presume that a large MSO will only pay a small fraction of the fixed costs necessary to develop a program leaving the programmer to collect a large portion of the fees from the overbuilder. That in turn, the argument goes, will make it impossible for the overbuilder to compete, driving it from the market. But this chain of reasoning breaks down once it is recognized that the programmer will not sink its costs if it does not expect to recover them. *See* Ordover Dec. ¶¶ 82-83. In this situation, the programmer would never develop the programming in question because it knows that if incumbents that serve the vast majority of subscribers only pay a small fraction of the costs, it is unlikely to be able to recover its remaining costs from the new entrant overbuilder. Knowing this, the MSO would not engage in the feared behavior.

In sum, although hold-up and free-riding are clearly relevant dynamics in this context, they are not caused by cable ownership concentration, but by the cost structure and non-rival nature of video programming. Market participants have found ways to address these issues through contractual relationships and other means. Cable ownership concentration limits would do nothing to improve on the market solutions. To the contrary, ownership limits could well exacerbate any "hold-up" problems, because increased cable ownership concentration better aligns the incentives of MSOs and video programmers with regard to the production and distribution of quality programming.

3. Vertical Foreclosure by Cable MSOs is Not a Realistic Concern.

The "foreclosure" theory noted by the Commission hypothesizes that "MSOs with large programming interests may unfairly favor affiliated programming over unaffiliated programming." *Notice* ¶ 29. According to this theory, the MSO will foreclose in order to drive rival programmers out of the market and thereby gain power in the programming market. That in turn, will allow the MSO's affiliated programmer to raise the prices it charges to other MSOs. But the strategy also imposes costs on the MSO. By denying carriage to rival programmers, the MSO will decrease the overall value of its cable service offerings, and will therefore lose subscribers to retail rivals (and consumers that simply choose not to purchase an MVPD service). Accordingly, this strategy makes sense only if the MSO hopes to gain more revenues by increasing its programming rates than it loses from denying carriage to unaffiliated programming.

A cable MSO's incentives to attempt this foreclosure are strongly linked to its ownership in video programming. *See* Ordover Dec. ¶ 93. But the *Notice* makes no attempt to link the subscriber limit with the extent, if any, of programming that an MSO owns. At the outset, therefore, an across-the-board, one-size-fits-all limit totally decoupled from MSO programming ownership would appear to run afoul of the Commission's obligation to ensure that a horizontal limit does not "burden substantially more speech than necessary," *Time Warner II*, 240 F.3d at 1130.

Moreover, a cable MSO's incentives to undertake foreclosure rapidly *decline* the larger it grows. Obviously, a large MSO stands to suffer greater customer losses from foreclosure than a small MSO. Ordover Dec. ¶ 94. And because cable companies incur high fixed costs regardless of the number of subscribers served, the loss of even relatively few subscribers has a significant impact on a cable company's bottom line. Declaration of Stanley Besen ("Besen Dec.") ¶ 22 (attached hereto as Appendix B) At the same time, the larger the MSO, the *lower* the gains from foreclosure because the larger the foreclosing MSO, the fewer subscribers served by rival distributors and thus the lower the revenues to be gained by the MSO's programming affiliate from exercising market power over rival distributors. Thus, a foreclosure strategy is unlikely to be profitable for any MSO remotely large enough to carry it out, because the limited gains are unlikely to offset the losses. Besen Dec. ¶¶ 41-57.

Finally, Professor Ordover explains that the *ability* of even a large cable MSO to exercise foreclosure power in this context is quite remote. In particular, there are two essential pre-conditions for the exercise of foreclosure power. First, the MSO must control a sufficient percentage of *all* distribution channels to which rival video programmers could turn in order to be able to drive them out of business. Ordover Dec. ¶ 98. Second, the MSO must be able to then gain non-transitory power (that it did not have previously) over the price of programming. *Id.* ¶ 99.

The Ability to Foreclose. To be successful, a foreclosure strategy requires that an MSO prevent a programmer from reaching a sufficient base of subscribers to be viable. Ordover Dec. ¶¶ 100-22. But even if the Commission were to consider only U.S. MVPDs – despite the overwhelming evidence that programmers can and do sell significant amounts of content to non-

MVPDs program purchasers and to non-U.S. MVPDs – it is difficult to see how even a very large MSO could effectively foreclose any programmer's distribution.

As an initial matter, MSOs have only a limited ability unilaterally to refuse to deal with a programmer. A programmer can obtain carriage without the cable company's cooperation by making a carriage deal with a broadcast TV network that is guaranteed cable access through "must carry" regulations, 47 U.S.C. § 534, any of the dozens of programming networks that market forces require MSOs to carry, or pursuant to the leased access regulations. *Id.* § 532.[56]

In all events, the "*availability*" of DBS places a significant, real-world constraint on the ability of any MSO to foreclose programmers. *Time Warner II*, 240 F.3d at 1134 (emphasis in original) (citing *AT&T Corp. v. Federal Communications Commission,* 236 F.3d 729, 736 (D.C.Cir.2001)). As discussed in detail above, consumers view DBS and cable as substitutes and have demonstrated that they will readily switch from cable to DBS if they view cable's offering as inferior. Further, DBS has the capacity and ability to serve virtually every cable consumer in the U.S. Any action by a cable MSO that degraded the quality of its programming – which would be the case if the MSO were to foreclose quality programming – would therefore cause the MSO to lose customers to DBS.[57] And, as noted above, any programmer refused cable carriage would look to DBS' expected subscriber base over the life of a multi-year contract, taking into account the likely impact of self-destructive cable behavior, not simply to the current DBS subscriber base.

[56] Although this costs the programmer money, the programmer can still earn a profit through the sale of advertising – revenues it does not have to share with the MSO.

[57] Of course, it is conceivable that failure to carry some services might result in small subscriber losses. However, "because these would be services on which subscribers place relatively low value, or services for which there are many good substitutes, their foreclosure would be unlikely to permit operators to raise the price of is affiliated program service." Besen Dec. ¶ 53.

Moreover, an appropriately dynamic inquiry must also consider the ability of programmers to undertake "self-help" in the face of foreclosure by a cable MSO. In this regard, it is important to recognize that a programmer's costs are not fixed and that a programmer may be able to reduce its costs and still maintain the same programming quality. As Dr. Besen explains (¶ 11), programming costs often include rents – *i.e.*, payments that exceed the opportunity costs of the inputs needed to produce programming. For example, the exact same talent that appears on a particular situation comedy may still be willing to work even if their wages are somewhat reduced. Thus, a programmer may have the ability to reduce its costs simply by squeezing out some or all of the rents that its own suppliers are earning while still paying enough to induce the supplier to provide the same quantity and quality of inputs as before. Likewise, as Professor Ordover explains, programmers have effective counter-strategies that can be employed to prevent foreclosure, including "bundling" of less desirable programming with "must have" programming (*e.g.*, MTV and ESPN). Ordover Dec. ¶¶ 121-22; *see also* Besen Dec. ¶ 18.

Exploiting Power Over Programming To Offset The Losses From Vertical Foreclosure. To succeed, an MSO adopting a foreclosure strategy also must gain power over the price of programming. Ordover Dec. ¶¶ 123-27. Otherwise, all the MSO has done is incur losses (from refusing to carry valuable programming) without any corresponding gains. A determination as to whether the MSO could acquire such power requires a rigorous examination of the susceptibility of the "secondary" market to monopolization. Where, as here, the secondary market is deconcentrated and entry is possible, there is little prospect that the foreclosing party can gain market power.

Where several programmers compete with the foreclosing MSO's programming, simply disabling one or two would not be sufficient to gain market power, because the remaining programmers would still constrain the rates the MSO's affiliated programming can charge. Ordover Dec. ¶ 127. Because it is reasonable to expect that, in many cases, a single programmer can provide effective competition, the foreclosing MSO would need to disable *all* of its affiliated programmer's rivals. Given the number of programmers in each "segment" of the market (*e.g.*, sports programming, news programming, entertainment programming), and the strength of many of these programmers (many of which are aligned with multi-national corporations like Disney, Viacom and AOL Time Warner), even a foreclosure attempt that successfully drove a rival programmer out of business would unlikely to be profitable.

And even if an MSO could drive all existing rival programmers out of the market, the MSO's programming affiliate still would face potential competition from new entrants. Ordover Dec. ¶¶ 124-25. In this regard, barriers to entry into programming must be considered modest, given the number of program services in existence and the number of new program services under development. *Id.* ¶ 124. The competitive constraint imposed by new entry should be particularly strong in many cases because the content used by the disabled programmer does not disappear. *Id.* ¶ 126. The content provider(s) that formerly supplied the foreclosed program packager would have a strong incentive to reach terms with a new program packager to allow distribution of the content. And the terms of the deal could be quite favorable to the packager, given that the costs of already produced content would be sunk. Thus, a new entrant could reacquire the content that was used by the foreclosed program packager, but at a price that would be sufficient to allow it to earn a return on investment even if the foreclosing MSO continues to block access to its subscribers.

Finally, a dynamic analysis must also take into account how other MVPDs would respond to an MSO's attempt to undertake foreclosure. These MVPDs would have strong incentives to block this strategy because they would be the ultimate victims, and there is thus "the potential for payments to be made from the disadvantaged MVPDs to the disadvantaged program service that will prevent it from going out of business."[58]

D. Existing Safeguards Cannot Be Ignored.

Even if it could be demonstrated that a serious, non-conjectural risk would exist absent regulation, the First Amendment requirement that the Commission not "burden[] substantially more speech than necessary," *Time Warner II*, 240 F.3d at 1130, would compel the Commission to consider the extent to which *other* regulations already protect the government's interest in enhancing effective competition. Existing behavioral and structural laws and regulations clearly do protect the interests at issue here, as the Commission itself has recognized.

Most significantly, the Commission's program carriage rules target the very same conduct that a fixed numerical subscriber limit would seek to prevent. The 1992 Cable Act (and accompanying Commission regulations) specifically prohibit a cable operator from discriminating against an unaffiliated programmer in the terms and conditions of carriage based on the programmer's non-affiliation. *See* 47 U.S.C. § 536(a)(3); 47 C.F.R. § 76.1300 *et seq.* The regulations broadly prohibit a cable company from engaging in any conduct that "unreasonably restrain[s] the ability of an unaffiliated video programming vendor to compete fairly." 47 C.F.R. § 76.1301(c). In the eight years since these rules were adopted, only one

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[58] Besen Moresi & Woodbury, *An Economic Analysis of the Effects of the AT&T-MediaOne Merger on Competition in the Supply and Distribution of Video Program Services*, CS Docket No. 99-251, at 50-51 (filed Sept. 17, 1999).

program carriage case has been brought, and it was settled.[59] Because programmers have every incentive to challenge predatory conduct by cable operators, the fact that only one case has been filed in eight years demonstrates that such conduct is conjectural at best.

Other Commission rules prevent cable operators from excluding non-affiliated programmers from their cable systems or from precluding programmers from reaching consumers through alternative outlets. For example, the Commission's "must carry" regulations ensure that a programming network can obtain carriage without the cable company's cooperation by making a carriage deal with broadcast stations/networks that are guaranteed cable access. *See* 47 U.S.C. § 534 (requiring up to one-third of a cable system's channel capacity to be devoted to must-carry stations). Similarly, the leased access rules allow programmers to purchase access directly from the cable company at rates and terms regulated by the Commission. *See id.* § 532 (requiring cable systems to set aside up to fifteen percent of channel capacity for these commercial leased access programmers).

The Commission itself has recognized the efficacy of these and other rules and prohibitions. In its *Second Order on Reconsideration*, the Commission acknowledged that:

> Statutes and rules such as the program access, program carriage, channel occupancy limits, and must-carry requirements all affect the way the cable television industry currently operates and have a profound effect on current industry structure and performance. . . . Because these provisions have *real and substantive impact upon the market*, the Commission . . . may consider the impact of these provisions in alleviating some of the public interest and anticompetitive concerns about horizontal concentration.[60]

[59] Order, *Classic Sport Network v. Cablevision Systems Corp.*, 12 FCC Rcd. 22100 (1997).

[60] Memorandum Op. and Order on Reconsideration and Further Notice of Proposed Rulemaking, *Implementation of Section 11(c) of the Cable Television Consumer Protection and Competition Act of 1992, Vertical Ownership Limits*, 13 FCC Rcd. 14462, ¶ 50 (1998).

Beyond these behavioral and structural restrictions,[61] the Commission's ongoing video programming inquiries, in which it "monitor[s] the market for evidence of anti-competitive behavior by large cable operators," *Notice* ¶ 71, serve both to deter predatory conduct and to ensure prompt corrective measures should any such conduct occur. *See, e.g., 2000 Video Competition Report*, Apps. B & D (reporting extensive industry statistics including channel growth, revenues, capital acquisition, ownership concentration, vertical integration, popularity of programming and new entry). Should cable MSOs engage in predatory behavior, programmers would have ample opportunity and incentives to alert the Commission to such behavior. Such behavior, moreover, would be easy to detect. Any attempt to "foreclose" popular programming, for example, would require a denial of carriage arrangements, which would likely draw complaints from both consumers and the affected programmer. Even carriage disputes between MSOs and video programmers that clearly do not involve the exercise of market power make national news.[62]

The antitrust laws also provide powerful disincentives to predatory MSO conduct. Ordover Dec. ¶ 33. Indeed, the Commission has expressly recognized in other contexts that the antitrust laws provide significant protection against the exercise of both monopoly and monopsony power. *See, e.g.*, Seventh Report and Order, *Access Charge Reform*, 16 FCC Rcd. 9923, ¶ 85 (2001) ("We conclude that other remedies, like those under the antitrust laws, are

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[61] Any attempt to downplay the significance of the existing regulatory overlay as mere "behavioral" restrictions that must be supplemented with a "structural" subscriber limit not only ignores the efficacy of the existing regulations, but also mischaracterizes these regulations, several of which are themselves structural limitations.

[62] *See* Bruce Orwall & Joe Flint, *Disney, Time Warner Sign Deal*, Wall St. J., May 26, 2000, at B6.

available to protect [carriers] from the exploitation of any monopsony power that IXCs may possess").

IV. THERE ARE NO VALID "SHORTCUTS" TO THE REQUIRED DYNAMIC MARKET POWER ANALYSIS.

Markets are complex, and market power inquiries are necessarily context driven. As such, they are rarely susceptible to formulaic analysis. The *Notice* nonetheless inquires whether certain shortcuts – in particular, the "Implicit Lerner Index," the "q" ratio, the Herfindahl-Hirschman Index ("HHI"), and the "open field" approach used to support the limits struck down in *Time Warner II* – could be used in lieu of a dynamic market power analysis. *See Notice* ¶¶ 60-73. None of these simplistic measures could substitute for a rigorous economic examination of the video programming marketplace or satisfy the *Time Warner II* mandate.

A. The Implicit Lerner Index, The Q Ratio, And The HHI.

The Implicit Lerner Index uses differences between price and marginal cost as a proxy for market power. Ordover Dec. ¶ 157. That comparison, however, is of no possible relevance here. *Id.* ¶¶ 157-58. Both video programmers and cable companies have relatively high fixed costs and relatively low marginal costs – once the necessary cable infrastructure costs (or programming production costs in the case of a video programmer) have been sunk, the marginal cost of adding an additional subscriber (or program purchaser) is relatively low. As the Commission has recognized in the context of local telephone markets, in such circumstances the competitive equilibrium is that prices tend towards long run, incremental cost, not marginal cost. First Report and Order, *Implementation of the Local Competition Provisions in the Telecommunications Act of* 1996, 11 FCC Rcd. 15499 ¶¶ 672-93 (1996).

The "q" ratio – which measures the ratio of a firm's market value and the replacement cost of the firm's physical assets – is similarly inapplicable. *Id.* ¶ 159. The q ratio is generally used to estimate a *seller's* market power and could not be practically applied in this context. To attempt to apply it here to estimate buyer market power would, at a minimum, require extensive data on the replacement costs of video programming. And even if that data were available, the available market value data would be of little use, because many video programmers (and cable companies) have interests in other lines of business (which are not necessarily traded as separate stocks). Therefore a positive q ratio (to the extent it was meaningful at all) might signal only that the firm has market power in an unrelated business. And, again, the q ratio lacks the predictive value needed to assess market power at different hypothesized levels of ownership concentration.

Although the HHI is practical to implement, it measures only *static* concentration. *Id.* ¶ 160. As such, it clearly does not respond to the *Time Warner II* mandate to reflect the *availability* of alternative distribution channels and the willingness of customers to switch. It is also important to recognize that the antitrust authorities do not use HHIs as absolute caps, but only to establish presumptions that may be rebutted on the basis of the very types of dynamic economic evidence that *Time Warner II* directed the Commission to consider. *See Horizontal Merger Guidelines* § 1.5.

B. The "Open Field" Approach.

As discussed above, the "open field" approach employed in prior orders plainly is not a real-world, dynamic market analysis, because it looks exclusively to static subscribership and concentration levels in assessing the "field" open to a programmer that is denied cable carriage. It ignores entirely not only the ability of DBS and other cable competitors to attract cable customers in the face of cable's refusal to carry programming that customers want, but also the many non-MVPD and non-U.S. distribution and revenue options open to video programmers in today's marketplace. For these reasons alone, any subscriber limit based upon an "open field" analysis is foreclosed by *Time Warner II*. But even if *Time Warner II* (and sound economics) did not authoritatively foreclose an open field approach, no open field-based limit could likely be sustained, because that approach, by definition, necessitates a series of arbitrary and unsupportable simplifying assumptions.

1. The Size of the Open Field.

The 30% subscriber limit which the court overturned was "premised on the Commission's belief that a new programming network needs to reach approximately 20 percent of the 80 million MVPD subscribers in order to succeed" and is "further premised on the theory that a network has a 50 percent chance of obtaining subscribers on systems that are not actively denied to it." *Notice* ¶ 52. Based on these two assumptions, the Commission found that an open field encompassing 40 percent of the then-current 80 million MVPD subscribers was required. *Id.* However, there is no valid record support for either the 20 percent "minimum subscriber" figure or the 50 percent "success rate," and both of these critical assumptions are wholly inconsistent with the realities of today's marketplace.[63]

[63] The only support for the Commission's 40 percent open field premise cited in the *Notice* is the bare assertion – contained in the majority statement in a 1997 *FTC* decision approving adoption of a consent order in the Time Warner-Turner merger – that "because of the economies of scale involved, the launch of any significant new channel usually requires distribution on MVPDs that cover 40-60% of subscribers." *Notice* ¶ 53 (*citing In Re Time Warner, Inc.*, 123 F.T.C. 171, 207 (1997) (statement of Chairman Robert Pitofsky and Commissioners Janet D. Steiger and Christine A. Varney)) ("*FTC Time Warner Decision*"). The FTC provided no indication as to what, if any, evidentiary basis existed for this assertion. In addition, as one of the dissenting FTC commissioners observed, the majority's assertion is inconsistent with the FCC's own prior statements. *See* Dissenting Statement of Commissioner Mary L. Azcuenaga, *FTC Time Warner Decision* at 221, n.46. Moreover, as the *Notice* in this proceeding concedes, "it is important to note that the FTC decision was reached in 1997, when both MVPD competition and channel capacity were . . . at lower levels than today." *Notice* ¶ 53 (emphasis added). Indeed, the cited FTC statement itself, while asserting that, *at that time*, "[a]lternative technologies such as DBS have only a small foothold in the market," also recognizes that "these alternative technologies

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The Commission's Minimum Subscriber Assumption. The 20% minimum subscriber figure was based on the assumption that "the average cable network needs to reach 15 million subscribers to be economically viable." *Time Warner II*, 240 F.3d at 1131. However, as the chart below indicates, there are almost *50 national cable programming networks* that have been successfully launched and that remain in operation today with *fewer than 15 million* MVPD subscribers.

National Programming Services		
Programming Service	**Launch Date**	**Current U.S. MVPD Subscribers**
Oxygen	February-00	14,700,000
National Geographic Channel	January-01	14,100,000
MBC Network	June-99	13,000,000
Wisdom Television*	July-97	13,000,000
America's Store	September-86	12,400,000
SoapNet	January-00	11,700,000
GoodLife TV Network	February-85	11,600,000
Outdoor Channel, The	April-93	11,000,000
style.	October-98	11,000,000
CNN en Espanol	March-97	10,500,000
International Channel	July-90	10,400,000
Discovery Kids Channel	October-96	10,000,000
Discovery Science Channel	October-96	10,000,000
CNNI (CNN International)	January-95	10,000,000
The Barker**	N/A	10,000,000
BET Action PPV**	January-90	10,000,000
Sundance Channel	February-96	10,000,000
STARZ!	February-94	9,700,000
Free Speech TV (FStv)	June-95	9,000,000
TRIO	September-94	8,818,874
BET on Jazz: The Jazz Channel	January-96	8,400,000
Movieplex	October-94	8,000,000
America One Television**	February-95	8,000,000
Discovery Civilization Channel	October-96	7,000,000
Discovery Home & Leisure	October-96	7,000,000
Discovery Wings Channel	July-98	7,000,000
Classic Arts Showcase*	May-94	6,000,000
Fox Sports World	November-97	6,000,000

(. . . continued)
may someday become a significant competitive force in the market." *FTC Time Warner Decision* at 209.

National Programming Services		
Programming Service	**Launch Date**	**Current U.S. MVPD Subscribers**
HBO Latino	November-00	5,500,000
BET Movies/STARZ!**	February-97	5,000,000
Newsworld International	September-94	4,500,000
Fox Sports World Espanol	February-99	3,700,000
Weatherscan Local by The Weather Channel	October-99	3,500,000
STARZ! Family	May-99	3,000,000
STARZ! Theater	March-96	3,000,000
GEMS Television*	April-93	2,800,000
Inspirational Life Television	June-98	2,000,000
Boomerang*	April-00	2,000,000
Chinese Communication Channel	September-89	1,740,000
C-SPAN 3	September-97	1,400,000
B Move Channel**	December-99	1,050,000
Los Buenos Dias de HTV*	August-95	1,000,000
Oasis TV, Inc.	September-97	250,000
Golden Eagle Broadcasting	November-98	250,000
Celtic Vision	March-95	175,000
Filipino Channel, The	April-94	58,000
TV Asia	April-93	48,000
TV Japan	July-91	43,000

Source: National Cable and Telecommunications Association, except as otherwise noted
***Source**: Company data
****Source**: TELEVISION & CABLE FACTBOOK (vol. 69, 2001 ed)

This group includes a number of well-known networks that were launched more than five years ago (*e.g.*, BET on Jazz; Discovery, Kids Channel; STARZ!), as well as more recently launched networks (*e.g.*, Oxygen, National Geographic Channel). Although some of these networks are approaching 15 million subscribers, others (including some that are *more than five years old*) have *under 3 million* subscribers. These data are consistent with Dr. Besen's findings that advertiser-supported basic national programming services "can be, and are, viable even if they reach fewer than 15 million [U.S.] MVPD subscribers." Besen Dec. ¶ 3.

In addition, there are today at least 40 regional programming networks, *all of which serve* substantially *fewer than 15 million subscribers*. Three-fourths of these regional networks have been in operation for five years or more, and most, including several well-known and well-established regional networks (*e.g.*, the D.C. area's Comcast SportsNet and NewsChannel 8), are operating with *3 million or fewer subscribers.* A number of these regional networks (News12 Long Island and Pittsburgh Cable News Channel) have been operating for at least five years with *fewer than 1 million subscribers.*[64]

The *Notice* states that the 15 million minimum subscriber threshold "was intended to support the typical high-cost programming network that requires large audiences." *Notice* ¶ 54. There is no reason why the inquiry should focus on such networks. To the contrary, focusing on "high-cost" networks that tend to supply the most popular programming and are therefore *least* likely to be susceptible to any attempt by cable operators to exercise market power, would seem flatly inconsistent with marketplace reality.[65]

Moreover, the focus on high-cost programming services reveals another flaw in the open field approach. It assumes that all services need the same size open field to achieve viability. In reality, the size of the required open-field is highly individualized and will depend on the unique characteristics of each programming service, such as cost of production, extent of reliance on advertising, and geographic scope. And, as discussed in the attached Declaration of Dr. Besen, programmers have significant ability to adapt by, for example, adjusting costs, and therefore can achieve viability under a variety of open field scenarios. *See* Besen Dec. ¶¶ 3, 11, 14 (noting that "some cable program services may be able to adjust their costs in response to changes in coverage so that they can survive, and, indeed, prosper even at relatively low subscriber levels."). The number of subscribers for programming services operating today ranges from

[64] *See generally* Television Cable and Fact Book (vol. 69, 2001 ed.).

[65] *See* Janusz Ordover, *The Perils of Static Analysis of Unduly Narrow Markets*, MM Docket No. 92-264, CS Docket No. 98-82, at 10 (filed Oct. 1, 1999) (submitted as attachment to *ex parte* submission of AT&T Corp.).

under 50,000[66] to over 86 million,[67] and there are hundreds of services within this range. There is no a "one-size-fits-all" open field, or even a few sizes, that could adequately capture the myriad factors that permit such a range.[68]

In establishing the size of the open field, the Commission relied on statements made in prior video competition reports, suggesting that "to have a long-term prospect for success, the *initial subscriber requirement* for a new channel would be at least 10 to 20 million households."[69] Yet, the marketplace reality is that many of the most successful programming services launched with substantially fewer subscribers than 10 to 20 million and grew over time. For example, one of the services specifically cited in the *Notice* as an example of the type of service that "requires large audiences," USA Network,[70] was initially launched in 1977, with far fewer than 15 million subscribers, as the Madison Square Garden Sports Network.[71] In 1980, it became the USA Network, providing general entertainment programming on a part-time basis,

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[66] *See National Programming Services supra* pp. 60-61.

[67] *See* National Cable & Telecommunications Association, *About the Industry - Program Networks - Top 20 Cable Networks* (http://www.ncta.com/industry_overview/top20networks.cfm?indOverviewID=59) ("NCTA Top 20 Cable Networks").

[68] *See Notice* ¶ 54 (acknowledging that "the necessary subscribership reach for success varies depending on the type of programming network").

[69] 1999 *Horizontal Order* ¶ 40 n.89; *1998 Video Competition Report* ¶ 152 (emphasis added); *see also* Fourth Annual Report, *Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming*, 13 FCC Rcd. 1034, ¶ 155 (1998) (asserting that the "conventional understanding" is that "a successful launch of a new mass market, advertisers supported national programming network – that is, the initial subscriber requirement for long-term success – *requires* that the new channel be available to at least fifteen to twenty million households") (emphasis added).

[70] *See Notice* ¶ 54 n.128.

[71] Michael Burgi, *Made for the USA*, Inside Media, Aug. 12, 1992 (1992 WL 11302311).

and, in 1981, it began operating 24 hours a day.[72] It took approximately six years before the network's subscriber base exceeded 15 million.[73] Similarly, CNN launched in June 1980 with 1.7 million subscribers and took approximately two years to exceed 15 million.[74] The Weather Channel launched in May 1982 with only *3,000* initial subscribers and it did not surpass 15 million subscribers until 1985.[75] The Discovery Channel had 150,000 subscribers at launch, and took several years to exceed 15 million subscribers.[76] Nickelodeon launched with 600,000 subscribers, and took more than four years to top 15 million.[77] Yet, all of these services are now highly successful and each has over 80 million subscribers. The modest beginnings, and steady gains in subscribership exhibited by these highly successful services underscore that the number of subscribers a service has *at launch* is irrelevant to predicting the ultimate viability of the service. Rather, these programs were able to launch with subscribership well below 15 million

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[72] *Id. See also* Jennifer Pendleton, *With the Program: Cable's USA Network Tunes Into Success with Strategy of New Original Productions*, Los Angeles Daily News, at B1 (Nov. 5, 1989).

[73] As of January 1982, USA Network had approximately 9 million MVPD subscribers. By November 1982, this total had risen to 13 million and by January 1984 it stood at 21 million. *See* CBA Continues Push to Respectability, UPI, Jan. 30, 1982 (available in LEXIS, Nexis Library, UPI File; Television & Cable Factbook (vol. 51, 1983 ed); Television & Cable Factbook (vol. 52, 1984 ed).

[74] *See* Turner Broadcasting System, Inc., *About TBS, Inc. – Timeline* (http://www.turner.com/about/timeline.html); Television & Cable Factbook (vol. 51, 1983 ed).

[75] *See* National Cable & Telecommunications Association, *Broadband Services - Programming* (http://www.ncta.com/guidebook_pdfs/weather_chan.pdf); NCTA Top 20 Cable Networks (http://www.ncta.com/industry_overview/top20networks.cfm? indoverviewID=59).

[76] *See* Discovery Communications, Inc., *Businesses & Brands* (http://www.discovery.com/corporate/brands/brands.html); Television & Cable Factbook (vol. 56, 1988 ed); NCTA Top 20 Cable Networks (http://www.ncta.com/industry_overview/top20networks.cfm?indoverviewID=59).

[77] *See* Museum of Television & Radio (http://www.mtr.org/exhibit/nick/nickla.htm); Television & Cable Factbook (vol. 52, 1984 ed).

and slowly build up recognition that later compelled other MVPDs to add the program to their channel line-up. In short, any attempt to identify a specific "threshold level" of subscribers that is required (either at launch or thereafter) for purposes of implementing a workable open-field approach to cable horizontal ownership is, necessarily, doomed to failure.[78]

The 50% "Success Rate" Assumption. The 50 percent "success rate" assumption employed in the open-field approach is entirely without foundation. The Commission has never articulated any valid basis for this assumption, and it is inconsistent with marketplace facts.

First, as the subscriber figures cited above illustrate, there are a number of programmers (including both cable-affiliated and non-affiliated programmers) that are viewed by more than 50 percent of *all MVPD subscribers*. Any general assumption that a programmer can expect to achieve carriage on only 50% of an "open field" (which is a *subset* of all MVPD subscribers) is therefore highly suspect. Ordover Dec. ¶ 145 ("The assumption is also contrary to logic. A 'disinterested' distributor cares only about the rate and the quality of programming. The worse is the "affiliated" programming and the higher is the rate charged for it, the more inclined will be the MVPD vendor to strike a deal with the allegedly foreclosed content provider.").

Second, as discussed above, competition in the MVPD market has grown rapidly, and this gives all cable operators strong incentives to *secure* carriage rights, rather than *deny* carriage to any programmer seeking to market appealing programming. Once a programmer gets even limited exposure and favorable consumer response to its programming, it becomes increasingly difficult, and indeed counterproductive, for cable operators to refuse to carry the programming.

[78] Notably, the number of MVPD subscribers today is at least 88.7 million (as compared to 80.8 million at the time the Commission's subscriber limit was adopted). Accordingly, imposing a 40% open field formula today would ensure programmers access to *17.74 million* subscribers, *almost 3 million* more than the Commission assumed were necessary to achieve the purposes of the horizontal rules.

Likewise, the substantial increase in channel capacity resulting from the deployment of digital technology, as the Commission has recognized in other contexts, *Second Report* ¶ 83, has greatly expanded cable and non-cable outlets for programming and increased the demand for programming by cable operators and other program purchasers and distributors, Ordover Dec. ¶ 146. These factors put upward pressure on any assumption about the success rate a programmer will achieve and confirm that the 50% success rate assumption is far too conservative.

2. The Collusion Assumption.

The Commission's prior orders used an assumption of collusion to transform the 60% subscriber limit, which *Time Warner II* recognized is all that a 40% open field assumption (if valid) would otherwise support, into a much more restrictive 30% limit. In *Time Warner II*, the court found that while "[t]he statute plainly alludes to the *possibility* of collusion" and grants the Commission "authority to take action *in the event that it finds collusion extant or likely*," the statutory reference to "*joint* actions by a group of operators of sufficient size" does not itself constitute "a congressional finding of actual or probable collusion" and "[s]uch findings have not been made." *Time Warner II*, 240 F.3d at 1132 (emphasis added). The court went on to conclude that "[n]one of the [Commission's assertions with regard to the possibility of collusion or other anticompetitive 'joint actions'] is supported in the record." *Id.* The court specifically rejected the Commission's reliance on "the economic commonplace that, all other things being equal, collusion is less likely when there are more firms," concluding that this observation alone provides an insufficient basis for inferring that there is a "non-conjectural risk of collusive rejection" of programmers by large cable operators. *Id.* at 1132-1133.

Any collusion assumption remains entirely conjectural. There does not appear to have been any such behavior at current or past concentration levels. In particular, both the attached Besen Declaration and the 1998 Besen & Woodbury Report demonstrate that cable operators have not disfavored unaffiliated programmers or unfairly favored affiliated programmers in their carriage decisions. Moreover, as the Ordover Declaration demonstrates, the Commission's collusion assumption "is inconsistent with basic economics," given the presence of significant legal, regulatory, and marketplace constraints, as well as other formidable obstacles to any express or tacit collusion attempt.[79]

The *Notice* invites comment (¶ 56) on "whether vertically integrated MSOs have incentives to reach carriage decisions that are mutually beneficial . . . to reduce costs" and, if so, whether such activities "fall within or outside the court's interpretation of collusion, or point to collusive behavior, or actually constitute collusion." However, *Time Warner II* expressly rejected the notion that the Commission may, in lieu of providing "substantial evidence" that collusion is occurring or is likely, rely on a showing that cable operators have cost reduction

[79] As Dr. Ordover observes, "[e]xpress collusion among MSOs designed to foreclose some programmer is, of course, subject to severe civil and criminal antitrust penalties that are generally thought to be adequate deterrence measures" and any attempt to engage in "tacit" collusion – *i.e.*, concerted action accomplished through the coordinated actions of several market participants – is also unlikely, particularly given the existence of a number of obvious and virtually insurmountable obstacles to such an arrangement. Ordover Dec. ¶ 147. These obstacles include the lack of an effective "signaling mechanism" as well as the absence of a means by which "MSOs could tacitly agree on the rate that should be paid for programming." *Id.* ¶ 150. Moreover, any collusion assumption in the context of a foreclosure strategy is "particularly far-fetched," because "expanding the number of 'foreclosing' MSOs increases the costs of the exclusionary strategy and decreases the revenues that could be generated should the MSOs actually be successful in raising rival programmer's costs," and because "no colluding MSO would agree to foreclose a programmer with which it is affiliated." *Id.* ¶ 151. Finally, "there is no 'safety in numbers' here that would overcome the central reason why a single large MSO could not credibly threaten to drop programming desired by customers" – "DBS and other

(continued . . .)

incentives that might induce them *unilaterally* to purchase the same programming. *See* 240 F.3d at 1135. The court noted that "*any* profit-maximizing firm will have an incentive to lower its costs," *id.* at n.6, and concluded that "the FCC has not shown why such pursuit of lower costs [by a cable operator] is by itself 'unfair,' and the statute allows for regulation *only* if unfairness can be shown," *id.* (emphasis added). More generally, as the court observed, "we cannot see how the word 'unfair' could plausibly apply to the legitimate, independent editorial choices of multiple MSOs." *Id.* at 1135 (emphasis in original).

Finally, as the *Notice* acknowledges (¶ 50), "the D.C. Circuit made clear that in order to sustain a limit below 60% (assuming the validity of the 40 percent open-field premise), the government must establish a record of *substantial evidence* showing the *existence or likelihood* of anticompetitive actions by a large MSO acting *individually* or by multiple MSOs acting *collusively*." (Emphasis added). No such evidence has been, or could be, established. Thus, even if the Commission decides to pursue an open-field approach, notwithstanding its serious flaws, it is plain that a subscriber limit of less than 60% cannot be justified. Since these inherent flaws in the open-field approach in any event cannot be squared with the court's mandate in *Time Warner II*, the Commission should decline to pursue this course and should instead adopt the market power-based approach described above.

V. THE SIGNIFICANT PRO-COMPETITIVE BENEFITS ASSOCIATED WITH INCREASED CABLE CONCENTRATION MUST ALSO BE CONSIDERED.

In § 613(f)(2)(D), Congress expressly directed the Commission "to take into account" the important efficiency benefits of cable expansions and territorial consolidations. Thus, even if

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(. . . continued)
competitors are waiting in the wings and willing and able at little cost to serve all cable customers." *Id.* ¶ 152.

there were a serious risk that cable ownership concentration would threaten video programmers in a competitively relevant way – and none has been demonstrated – the Commission would need to weigh that potential public interest harm against the significant public interest benefits of increased cable ownership concentration.

As Professor Ordover explains, there are clear, identifiable public interest benefits to increased cable ownership concentration. First, because of economies of scale in administration, operations, and research and development, larger MSOs can serve customers more effectively and at lower costs than smaller MSOs. Ordover Dec. ¶ 129. Relatedly, the cost incurred by a program service – and therefore, the cost MSOs must pay for programming – can be reduced by dealing with fewer cable systems. *See, e.g.*, Besen, Brenner, Woodbury, "An Economic Analysis of the FCC's Proposed Cable Ownership Restrictions," MM Docket No. 92-264 (filed Feb. 9, 1993).

Second, allowing increased cable concentration promotes Congress' goal in § 706 of the Telecommunications Act of 1996 ("1996 Act") to encourage widespread deployment of advanced telecommunications services to *all* consumers, as well as advanced digital cable services. Ordover Dec. ¶ 132. Recent history makes clear that large MSOs are most able to make the investments necessary for offering digital cable and advanced two-way services.[80] This is not only because large cable MSOs have economies of scale necessary to offer services in competition with incumbent local exchange carriers ("LECs") and other alternative providers, but also because smaller cable systems have less access to capital and technological research.

[80] *See Is Classic's Bankruptcy First Of Many*, Cableworld, at 50 (Nov. 19, 2001) (attributing bankruptcy of cable operator to fact that recovering costs to upgrade systems is more difficult for small cable operators).

Third, ownership limits inhibit the ability of cable MSOs to offer local telephone services in competition with incumbent telephone carriers. Ordover Dec. ¶¶ 134-38. The lack of local phone competition today is an enormous public interest harm. Despite the passage of the 1996 Act, the local telephone industry remains the largest monopoly in the American economy. Cable systems, which control last mile facilities, are much less dependent than other entrants upon the cooperation of incumbent monopoly LECs than other potential telephony competitors. As Professor Ordover explains, "entrenched incumbents . . . currently serve virtually all customers in concentrated and vast geographic areas . . . still retain significant competitive advantages in this battle. Long experience in this industry has convinced us of the importance of the scale and clustering efficiencies in the provisioning of local services." Ordover Dec. ¶ 138. Even the largest MSOs today are much more geographically diffuse than incumbent LECs and serve significantly fewer customers. And all of the LEC access lines are geographically concentrated, whereas most MSOs' cable systems are spread across several geographic regions.

VI. THE COMMISSION SHOULD ABANDON THE "SALE OF PROGRAMMING" ATTRIBUTION RULES BUT SHOULD RETAIN THE "SINGLE MAJORITY SHAREHOLDER" EXEMPTION TO ATTRIBUTION.

Time Warner II reversed the Commission's *1999 Attribution Order* in two important respects. First, the court "Circuit found that the Commission had not justified elimination of the single majority shareholder exception and thus vacated the Commission's repeal of it." *Notice* ¶ 88. Second, the court "found that the Commission had not justified . . . its application of the limited partnership insulation criteria to bar programming sales." *Id.* ¶ 87. In the *Notice*, the Commission asks for comment on whether there is additional evidence or analysis that could "support . . . the Commission's prior conclusions" in the *1999 Attribution Order*. *Id.* There is none.

A. A Rule Preventing Insulated Status As A Result Of Program Sale Is Impermissible.

In the *1999 Attribution Order*, the Commission found (¶ 64) that its attribution rules prevented a limited partner from insulating its interest if it sold programming to the limited partnership (the "no-sale rule"). *Time Warner II* rejected this rule, concluding that the Commission had "drawn no connection between the sale of programming and the ability of a limited partner to control programming choices [of the limited partnership.]" 240 F.3d at 1143. *Time Warner II* sharply constrains the Commission's ability to re-impose the no-sale rule. The court made plain that the Commission must show that any no-sale rule bears a "rational relation" to the underlying goal of a subscriber limit and was highly dubious that the Commission could make such a showing. *Id.* at 1143-44. As discussed below, the court's views were well-founded.

1. The No-Sale Rule is Irrational and Inconsistent with Commission Precedent.

A limited partner seeking insulated status must comply with each of the seven criteria set out in the Commission's rules, which include a bar on communications regarding the limited partner's day-to-day video programming operations and on the limited partner's active involvement in the management or operation of the video programming businesses of the partnership. *See 1999 Attribution Order* ¶ 64. Therefore, as the *Time Warner II* court pointed out, even if a limited partner, by virtue of sales of programming to the partnership, had the theoretical ability to control or influence the partnership's programming choices, "given the independent criterion barring even communications on the video programming business, exercise of that power would seem to be barred." 240 F.3d at 1143; *see also* Ordover Dec. ¶¶ 168-71. Given that the insulated limited partner must certify that it complies with the insulation restrictions, there is no rational basis for concluding that the limited partner is "materially involved in the partnership's video programming-related activities," the linchpin for insulation.

As Professor Ordover explains, if the no-sale rule were taken to its logical extreme, it would lead to the absurd conclusion that *all* cable programming services influence cable company programming decisions merely because they engage in arm's-length negotiations to sell programming to the cable company. Ordover Dec. ¶ 171 ("The buyer-seller relationship simply does not materially involve the seller in the buyer's decisionmaking process. Where a limited partnership chooses to fill one or more of its channels with video programming supplied by a limited partner that can legitimately certify (as it must to qualify for insulation) that it will not communicate with the partnership on day-to-day programming matters and that it has no recourse against a general partner that chooses the 'wrong' programming, there is no rational basis for a categorical assumption that the limited partner is involved in programming decisions relevant to the purposes of the horizontal ownership limit.")

Neither the Commission nor any party has ever submitted empirical evidence to show a relationship between program sale and control or influence over a cable operator's program choices. Prior to the Commission's adoption of the no-sale rule, there were numerous examples of insulated limited partners that sold programming to limited partnerships. If such sales enabled a limited partner to control or influence the partnership to favor the limited partner's affiliated programming, proponents of the no-sale rule would be able to show evidence of such behavior. *See Time Warner II*, 240 F.3d at 1132 (noting that "the economy is filled with firms that, like MSOs, display partial upstream vertical integration" and if that implies collusion, "one would expect the Commission to be able to point to examples").

Moreover, there is no reasoned basis for asserting that the partnership would gratuitously act to foreclose a rival of a program service which is owned not by the partnership itself, but by one of its limited partners. If the partnership were to foreclose a rival of the limited partner, the partnership would experience all the *loss* (in terms of subscribers that drop cable service offered by the partnership as a result of the foreclosure) but *none* of the gain, because it does not own the favored programmer.[81] Besen Dec. ¶ 19 n.22.

Denying a limited partner insulated status based solely on program sale is also inconsistent with a long line of Commission decisions recognizing that even an investor with a significant ownership interest in a licensee can also sell programming to the licensee without influencing the buyer's programming decision. *See, e.g.*, *BBC License Subsidiary*, 10 FCC Rcd. 10968 (1995); *BBC License Subsidiary*, 10 FCC Rcd. 7926 (1995); *Univision*, 7 FCC Rcd. 6672 (1992). Moreover, under the broadcast equity-debt plus rule, an investor can have up to 33% of the licensee and also provide the licensee up to 15% of its programming and still remain nonattributed. *See* 47 C.F.R. § 73.3555, note 2(j).

2. The Existing Insulated Limited Partnership Rules Cannot be Read to Support a No-Sale Rule.

Nor can the Commission's existing insulated limited partnership rules plausibly be read to embody a no-sale rule. First, the general requirement of the insulation rules is that an insulated limited partner may not be "*materially involved*, directly or indirectly, in the

[81] In addition, any such uneconomic unilateral action by the partnership on behalf of the limited partner is flatly prohibited by the partnership's fiduciary obligation to act in the best interests of the partnership. *See, e.g.*, Raymond W. Merritt & Martin Helpern, *The Partnership Handbook* 68 (1986); 59A Am Jur. 2d *Partnership* § 478; John C. Ale, *Partnership Law for Securities Practitioners* § 3.20 (2000). *See also* Ordover Dec. ¶ 164 ("Although not spelled out, the scenario the *Notice* seems to be contemplating is that the management of the cable MSO would seek to foreclose programming that competes with the programming of the minority shareholder. This makes no sense. Such actions would only harm the cable MSO by causing it to loose customers while any benefits would flow to the minority shareholder who would gain from the ability to increase the affiliated programmer's rates. . . . . Certainly no fiduciary principles require management to take actions that harm the company and only benefit a minority stakeholder.").

management or operation of the video programming-related activities of the partnership."[82] *See* 47 C.F.R. § 76.503, note 2(b)(2) (emphasis added). The mere fact that an otherwise insulated limited partner may sell programming to the partnership, however, cannot reasonably be said to "materially involve" the limited partner in the complicated internal decisionmaking process which a cable limited partnership goes through in purchasing programming. A cable operator purchases the right to distribute dozens, if not hundreds, of programming services. Each purchasing decision involves a variety of complex factors, such as price, consumer desires, channel capacity, and technology, each of which must be analyzed and weighed. For a large cable operator, the variables may be different from system to system or from region to region. Indeed, this is why a large cable operator's channel lineups vary widely among its systems. To conclude that a limited partner which sells a single programming service to a cable limited partnership has a "seat at the table" which allows it to "materially" impact the partnership's video programming decisions is unrealistic.

Second, criterion 6 of the insulation rules expressly bars an insulated limited partner from "perform[ing] any services for the partnership materially relating to its video programming activities, except that a limited partner may make loans to or act as a surety for the business." *See 1999 Attribution Order* ¶ 64. Criterion 6 prohibits the performance of video programming-related services *for* the partnership, not the selling of products *to* the partnership. Hence, for example, if the partnership hired the limited partner to buy or select video programming for the partnership or negotiate affiliation agreements on behalf of the partnership, then the limited

[82] Indeed, this is the only relevant question in the context of the cable horizontal ownership rule, in which the insulation rules aim to prevent a limited partner from exercising control or influence over the video programming decisions of the limited partnership. *See 1999 Attribution Order* ¶ 63.

partner would not qualify for insulation under the Commission's rules because it would be performing a service *for* the partnership materially relating to the partnership's video programming business.[83] In contrast, when a limited partner sells programming to the partnership, it is not performing a service *for* the partnership, any more than a typical retailer is performing a service for a customer when the customer buys the retailer's product. For example, if a consumer were to buy a lawnmower at Home Depot, that transaction would not be viewed as Home Depot performing a service for the consumer, but rather as Home Depot selling a product to the consumer.

3. The *Twentieth Century* Case, Even Assuming that it Was Correctly Decided, is Inapposite.

The Commission's 1989 decision in *Twentieth Century Holding Corp.*, 4 FCC Rcd. 4052 (1989) is not relevant to the instant review of the no-sale rule. First, *Twentieth Century* involved the relationship between a broadcast network and its *wholly-owned* affiliate station. The decision emphasized the uniqueness of this relationship and the special concerns the Commission has with regard to broadcast networks' control and influence over their affiliates, noting, for example, that "[t]he relationship between an affiliate and a network is substantial and on-going"

[83] This analysis accords with Commission precedent relating to criterion 6. For example, the Commission has determined that the limited partner's performance of legal services for the partnership relating to the partnership's media business would destroy the insulated status of the limited partner. *See Reexamination of the Commission's Rules and Policies Regarding the Attribution of Ownership Interests In Broadcast, Cable Television, and Newspaper Entities*, 1 FCC Rcd. 802, ¶ 15 (1986) (finding attribution where the partner provided legal services relating to the licensing and operation of the partnership broadcast station). The Commission reasoned that "a partner whose contribution to the partnership is in the form of personal services and expertise rather than in the form of a financial investment is the antithesis of a passive investor" and that "it is virtually inevitable that such a partner will become actively involved in partnership affairs." *Id.* ¶ 16. *Accord National Communications Industries*, 7 FCC Rcd. 1703, ¶ 7 (1992) (attributing limited partner that performed "routine" legal services *for* the partnership); *Magdalene Gunden Partnership*, 6 FCC Rcd. 5976, ¶ 7 (1991) (attributing limited partner that performed legal services under an ordinary fee arrangement *for* the partnership).

and that "[a] network affiliation goes to the essence of a station's operation." *Twentieth Century* ¶ 17; *see also id.* ¶ 15 n. 11 ("We are not dealing with infrequent or one-time contacts, but an extensive, on-going relationship."). In fact, a broadcast network provides its affiliates with the vast bulk of the programming they distribute, particularly during the key prime time hours.[84] By contrast, no single programmer generally provides a cable operator with more than a small percentage of the operator's programming. And whereas the broadcast network in *Twentieth Century* held 100% of the broadcast station, in no event could a limited partner seeking insulated status hold a greater than 33% interest in the partnership. *See* 47 C.F.R. § 76.501, note 2(i) (specifically subjecting limited partnership insulation rules to the cable equity-debt rule).

Second, *Twentieth Century* involved the placement of a broadcast property into a trust and was therefore subject to a different set of attribution rules.[85] Even assuming *Twentieth Century* was correctly decided, this *trust* case provides no basis for the Commission to make a decision in the *limited partnership* context to attribute limited partners who sell programming to the partnership.

Finally, the inaptness of *Twentieth Century* is further underscored by the fact that the Commission made no mention of the case when it first articulated the no-sale rule in the *1999 Broadcast Attribution Order*. Indeed, the Commission has never cited to this case in any of its

[84] *See, e.g.*, Report and Order, *Review of the Commission's Regulations Governing Attribution of Broadcast and Cable/MDS Interests*, 14 FCC Rcd. 12559, ¶ 60 n.129 (1999) ("1999 Broadcast Attribution Order") (noting that networks can supply up to 75% of an affiliate's programming).

[85] *Compare* 47 C.F.R. § 73.3555, Note 2(e) (insulation rules for broadcast-related trusts) *and id.* § 76.501, Note 2(d) (insulation rules for cable-related trusts) *with id.* § 73.3555, Note 2(g) (insulation rules for broadcast-related limited partnerships) *and id.* § 76.501, Note 2(f) (insulation rules for cable-related limited partnerships).

earlier attribution proceedings or in its court briefs in *Time Warner II* as a possible basis for its no-sale rule.

B. There Is No Theoretical Or Empirical Basis To Eliminate The Single Majority Shareholder Exemption.

The law of corporate governance, fundamental economic principles, and the Commission's own findings in a number of orders stretching over nearly twenty years make plain that there is no sound theoretical or empirical basis to eliminate the "single majority shareholder" ("SMS") exemption.

The Commission first promulgated a SMS exemption in a 1984 decision concerning attribution rules for broadcast licensees. That order provided that an otherwise attributable minority interest in a company with a single majority shareholder was exempted from attribution, because in such a situation the minority owners could not direct the corporation's affairs. Report and Order, *Corporate Ownership Reporting And Disclosure By Broadcast Licensees*, 97 F.C.C.2d 997, ¶ 21 (1984) ("*1984 Broadcast Attribution Order*"). The *Second Report* establishing horizontal and vertical cable ownership limits adopted the broadcast attribution criteria, including the SMS exemption. The *1999 Attribution Order* eliminated (¶ 81) the cable version of the SMS exemption, although the Commission retained that exception in the broadcast arena until 2001. *Time Warner II* reversed the elimination of the cable SMS exemption, ruling that "[r]emoval of the exemption . . . . requires some affirmative justification, yet the Commission effectively offers none." *Time Warner II*, 240 F.3d at 1143.

The Commission acknowledged when it first adopted an SMS exemption that in a corporation with a single majority shareholder, "the minority interest holders, even acting collaboratively, would be unable to direct the affairs or activities of the licensee on the basis of their shareholdings." *1984 Broadcast Attribution Order* ¶ 21. It is black-letter law that "[m]ajority shareholders have the right to manage and control the corporation . . . ." 12B Fletcher Cyclopedia of Private Corporations § 5783. Apart from their fiduciary obligations or duties imposed by contract, majority owners are limited only by the very broad contours of the business judgment rule.[86] And while the *Notice* correctly observes (¶ 90) that "directors and officers have certain fiduciary duties, which may make it necessary to be responsive to the interests of minority shareholders," no reasonable interpretation of those duties supports the claim that a corporation's management has either the obligation or the right to act in a manner that injures the company in order to benefit a minority stakeholder. *See* Ordover Dec. ¶ 164.

The *1999 Attribution Order* expressed (¶ 81) "concern" – but provided no evidence – "that a minority shareholder *may be able to exert influence* over a company even where a single majority shareholder exists." (Emphasis added). The *Notice* echoes (¶ 90) this concern, inquiring whether the cable attribution rules should seek to attribute interests that permit a shareholder to exert "influence over the licensee's core operations." It is crucial to recognize, however, that "influence" is relevant only to the extent it extends to the issue the attribution rules are intended to address – that is, to decisions concerning the purchase of video programming. *See* Ordover Dec. ¶ 161. The fact that a minority holder has rights that belong to any share owner, such as the ability to vote on issues requiring shareholder approval, is simply irrelevant – even the holder of a single share of a large, publicly owned company possesses similar "influence," but that stake would never be subject to attribution.

[86] *See, e.g.*, *Fairchild v. Bank of America*, 13 Cal. Rptr. 491, 493 (1961) ("In the absence of fraud, breach of trust, or transactions which are *ultra vires*, the conduct of directors in the management of the affairs of a corporation is not subject to attack by minority stockholders in a suit at equity, where such acts are discretionary and are performed in good faith . . . .") (citation omitted).

The *Notice* speculates that a minority shareholder with a relatively large stake might "have influence by virtue of . . . their ability to withdraw that investment." *Notice* ¶ 90. As shown in the Ordover Declaration, that concern is baseless. The holder of a minority stake has no right to walk away with a portion of the assets of the corporation. At most, a minority shareholder can sell its equity interest; but the corporation itself should be indifferent to such a sale, as it does not share in the gains or losses of that transaction. Ordover Declaration ¶ 165. Similarly, a minority owner's "access to confidential information," *Notice* ¶ 90, provides no means to influence or control management's decisions concerning programming purchasing, Ordover Dec. ¶ 166.

The Commission repeatedly found that its rules adequately attributed cable ownership interests during the period in which the SMS exemption was in place. The *Second Report* noted (¶ 34) that in the broadcast context "[t]here are several exceptions" to the 5% attribution benchmark, "[m]ost notably" the single majority shareholder exception. The Commission went on to observe that these broadcast attribution rules "focus on ownership thresholds that enable a broadcast licensee to *influence* or control management or programming decisions." *Id.* ¶ 35. The Commission's implicit conclusion that the SMS exemption was consistent with the underlying purposes of the attribution rules follows from the basic legal principles cited above. An entity eligible for the SMS exemption has no power to compel a majority owner to heed its wishes, and no legal recourse that is not also available to any minority owner, including holders of stakes below the Commission's attribution threshold.

The above analysis also makes clear that there is no logical reason why the SMS exemption should be limited by the equity-debt ("ED") rule. But if the ED rule were to be interpreted as broadly as the *Notice* suggests (¶ 89), there can be no conceivable grounds for eliminating the SMS exemption. In the *1999 Broadcast Attribution Order*, which was the model for the cable ED rule, the Commission explained that the ED rule assures that "attribution is not limited to relationships that permit control, but also extends to relationships that permit sufficient influence over core operations of the licensee such that they should be subject to the multiple ownership rules. We believe that the [ED rule] will address such relationships that may inappropriately avoid attribution under our current rules." *1999 Broadcast Attribution Order* ¶ 38. The order went on to conclude that the ED rule "will focus directly on those relationships that may trigger situations in which there is significant incentive and ability for the otherwise nonattributable interest holder to exert influence over the core operations of the licensee." *Id.* ¶ 47.

When it imported the ED rule into its cable ownership regulations, the Commission again explained that the requirement was intended to capture interests with the "potential . . . *to exert significant influence* over key decisions . . . ." *1999 Attribution Order* ¶ 83 (emphasis added). The *1999 Attribution Order* reaffirmed this conclusion when it explained that the ED rule's threshold was set at 33% because the Commission's goal was "not merely to attribute interests with the potential to control but also those with a realistic potential to exert significant influence." *Id.* ¶ 86.

Accordingly, the Commission repeatedly has found that a minority owner's potential to "influence" corporate decision making is addressed by the ED rule and it would make no sense to eliminate the SMS exemption to capture interests sufficiently small that they do not even trigger attribution under the ED rule. If anything, that potential influence can only be *diminished* in circumstances in which an owner controls less than 33% of the equity-plus-debt in a corporation with a single majority shareholder – particularly in light of the Commission's prior findings that the SMS exemption is, in itself, consistent with the Commission's desire to assure that a minority owner cannot influence a licensee.

CONCLUSION

For the foregoing reasons, the Commission should conduct this proceeding in accordance with the dynamic market power analysis mandated by *Time Warner II* and the Commission's own longstanding policies. The Commission should also reinstate the single majority shareholder exemption, but not reinstate the non-sale rule for insulated partners.

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January 4, 2002

CERTIFICATE OF SERVICE

I hereby certify that on this 4th day of January, 2002, I caused true and correct copies of the forgoing Comments of AT&T Corp. to be served on all parties by mailing, postage prepaid to their addresses listed on the attached service list.

Dated: January 4, 2002
Washington, D.C.

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