Before the

FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of:	)	
	)	
Implementation of the Cable Television Consumer Protection And Competition Act of 1992	)	
	)	CS Docket No. 01-290
Development of Competition and Diversity In Video Programming Distribution: Section 628(c)(5) of the Communications Act:	)	
	)	
Sunset of Exclusive Contract Prohibition	)	

REPLY COMMENTS OF ECHOSTAR SATELLITE CORPORATION

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SUMMARY

EchoStar strongly supports extension of the prohibition on exclusive video programming contracts enacted by Congress in the Cable Television Consumer Protection and Competition Act of 1992 ("1992 Cable Act") beyond October 5, 2002. In its initial comments in this proceeding, EchoStar demonstrated why it is imperative that the Commission retain the exclusivity rule, which is of critical importance to increasing competition to still-dominant cable providers in the multichannel video programming distributor ("MVPD") market. In these Reply Comments, EchoStar responds to the main arguments of the opponents of extending the exclusivity prohibition. Those opponents are virtually all well-entrenched cable operators, many of them vertically integrated with programmers, that stand to reap enormous competitive advantages and increase their market power if the ban is lifted. They have provided the Commission no basis on which to permit this essential rule to sunset.

The opponents portray the MVPD market as a highly competitive one, in which they are being hobbled in their efforts to keep up with Direct Broadcast Satellite ("DBS") and other alternatives to traditional cable by the need to adhere to the program access rules, including the exclusivity ban. The reality, of course, is far otherwise. The continued dominance of cable in the MVPD market is indisputable. With a national market share of almost 80%, and market shares in certain local markets significantly higher than that, the contention that cable companies no longer possess substantial market power in the distribution market is unsustainable. The ability of cable alternatives like DBS to offer comparable programming is essential to their ability to constrain the pricing power of the cable companies, thereby lessening the need for burdensome rate regulation. It is not credible to contend that this market is currently so

competitive that the need for comparability of programming between cable and non-cable MVPDs has disappeared.

The basic conditions that led Congress to impose the exclusivity ban in 1992 have not changed. Cable operators continue to have both the incentive and the ability to "lock up" desirable programming produced by vertically integrated video programmers through exclusive contracts that leave competitors like EchoStar in a severely disadvantaged situation. It is not enough to say that the market for video programming is competitive, and non-cable MVPDs can simply look elsewhere for comparable programming. From the consumers' point of view, the ability to offer the "full slate" of expected cable programming is all-important, and an MVPD that could not do so (that could not, for example, offer HBO, CNN or some not-yet-launched network that is vertically integrated with a cable operator) may find itself unable to compete at any price with the incumbent cable operator. Nor, contrary to the ban's opponents, will extending the current exclusivity rule reduce the incentives for new and more diverse programming. The substantial growth in new programming services during the period the ban has been in effect confirms that this concern is wildly overblown. Moreover, to the extent there may be instances in which exclusivity is necessary to development of a new and untested programming service, the waiver provision within the existing rule is more than adequate to address such situations.

The recent agreement between EchoStar and Vivendi, a programmer that does not own any cable systems, demonstrates that exclusivity is not essential to the creation of new programming. Vivendi has agreed, among other things, to develop five new cable programming channels, and EchoStar has agreed to distribute them. Far from being premised on exclusivity, this arrangement is structured to encourage the opposite—carriage on as many distributors as possible. This structure confirms that one of the primary objectives of any firm not possessing market power in the downstream distribution market is the broadest possible dissemination among alternative distribution platforms.

In any event, the exclusivity rule has plainly contributed to the growth of programming diversity by facilitating DBS competition and thereby fueling a substantial increase in channel capacity. Because of the DBS competition made possible by the exclusivity ban, cable firms have been pressured to invest in additional channel capacity, which has encouraged new programming services. In addition, DBS firms have played an important role as launch platforms for independent programmers.

For cable-affiliated programmers, the desire for broad distribution of the programming is offset by the expectation of additional downstream revenues from the end consumer if the cable system affiliate can distribute the programming to the consumer on an exclusive basis. Of course, for exclusivity to pay in this situation, the distributor generally needs to have market power downstream, which it can protect and further leverage by excluding competitors from that programming.[1] This appears to explain the ardent interest of the cable industry in obtaining the ability to enter into exclusive carriage agreements. This is not to say that a vertically integrated programmer's legitimate incentives will not sometimes militate towards exclusivity, as they do sometimes in the case of unaffiliated programmers. The Commission, however, can always permit an exclusive deal involving cable-affiliated programming under the current rules when it is truly pro-competitive. On the other hand, a

[1] While a dominant cable system can distort the incentives of an independent programmer too by paying an exclusivity premium, it is easier to effectuate this anti-competitive incentive when the programmer is vertically integrated with one or more cable MSOs and the benefits from foreclosure are, at least in part, already internalized.

blanket blessing of all such exclusives does not make sense in light of the anti-competitive incentives that are part of the calculus for a cable-affiliated programmer.

Not only is the anti-competitive incentive of foreclosure present in the calculations of cable-affiliated programmers, but foreclosure has also been shown to be effective. Comcast's Philadelphia sports exclusives appear to have paid off: the pace of EchoStar customer acquisitions in Philadelphia has been significantly slower than in other cities where EchoStar carries the regional sports programming. Past experience, therefore, shows both that cable-affiliated programmers will act on their anti-competitive incentives if left unrestrained, and that this conduct has been profitable to them in the past, encouraging them to act in the same manner in the future.

While necessary, continuation of the ban on exclusive deals is far from enough to avoid anti-competitive behavior with respect to cable programming. Vertical integration aside, cable operators retain enormous buying power in the programming market, and have clear incentives to use this power in concert to extract preferential terms from independent programmers. The recently announced proposal to merge the cable systems of AT&T and Comcast may magnify exponentially the risks of such anti-competitive conduct. EchoStar recognizes that Congress has given the Commission limited authority to tackle this problem. EchoStar hopes that its proposed merger with Hughes will, if approved, curtail the problem. As EchoStar has explained in the merger application, that transaction will create a non-cable distributor that can offer programmers a significant enough subscriber base to limit the significant disparity in programming carriage terms that EchoStar now suffers compared to the large cable MSOs.[2]

[2] The opponents' attempts to manufacture a constitutional issue here are unavailing. The D.C. Circuit has already upheld the existing exclusivity rule against a First Amendment challenge, *Time Warner Entertainment Co. v. FCC*, 93 F.3d 957 (D.C. Cir. 1996), and there is no reason to believe the outcome would change merely because the Commission extends the existing rule beyond October 5, 2002. Moreover, the Commission has been specifically directed by Congress that the rule should be extended if the agency finds that the "prohibition continues to be necessary to preserve and protect competition and diversity in the distribution of video programming." 47 U.S.C § 548(c)(5). The Commission should therefore follow its usual practice of deferring constitutional issues to the courts, concentrating instead on making the judgment Congress has directed it to make. As shown below, that judgment can only be that the prohibition continues to be necessary, and that it therefore should be extended.

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REPLY COMMENTS OF ECHOSTAR SATELLITE CORPORATION

EchoStar Satellite Corporation ("EchoStar") hereby submits its Reply Comments in response to the initial comments filed by various parties with respect to the Commission's Notice of Proposed Rulemaking ("NPRM") in this proceeding. The focus of the NPRM is on the question whether the prohibition on exclusive video programming contracts enacted by Congress in the Cable Television Consumer Protection and Competition Act of 1992 ("1992 Cable Act") should be continued beyond October 5, 2002. In its initial comments, EchoStar demonstrated why it is imperative that the Commission retain the exclusivity rule, which is of critical importance to preserving the increasing competition in the multichannel video programming distributor ("MVPD") market. In these Reply Comments, EchoStar responds to the main arguments of the opponents of extending the exclusivity prohibition. Those opponents are virtually all well-entrenched cable operators, many of them vertically integrated with programmers, that stand to reap enormous competitive advantages and increase their market share if the ban is lifted. They have provided the Commission no basis on which to permit this essential rule to sunset.[3]

The opponents portray the MVPD market as a highly competitive one, in which they are being hobbled in their efforts to keep up with Direct Broadcast Satellite ("DBS") and other alternatives to traditional cable by the need to adhere to the program access rules, including the exclusivity ban. The reality, of course, is far otherwise. The continued dominance of cable in the MVPD market is indisputable. With a national market share of almost 80%, and market shares in certain local markets significantly higher than that, the contention that cable companies no longer possess substantial market power in the distribution market is unsustainable. The ability of cable alternatives like DBS to offer comparable programming is essential to their ability to constrain the pricing power of the cable companies, thereby lessening the need for burdensome rate regulation. It is not credible to contend that this market is currently so competitive that the need for comparability of programming between cable and non-cable MVPDs has disappeared.[4]

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[3] The principal opponents of extending the exclusivity ban are the large multiple system operators ("MSOs") that have the most to gain from tilting the competitive playing field further in their direction, including AT&T Corp. ("AT&T"), Comcast Corporation ("Comcast"), AOL Time Warner Inc. ("AOL Time Warner"), and Cablevision Systems Corp. ("Cablevision"). Extension of the ban is also opposed by the cable industry's principal trade association, the National Cable & Telecommunications Association ("NCTA") and by iN DEMAND L.L.C., a pay-per-view provider that is partially owned by AT&T Broadband. These entities are referred to collectively herein as "the opponents."

[4] Because of their concern over the inaccurate portrayal of the MVPD market in the comments of certain of the opponents, EchoStar and DIRECTV jointly retained three economic experts (Jonathan M. Orszag, Peter R. Orszag, and John M. Gale) to prepare an analysis of the current state of the market and the continued need for the exclusivity ban. A copy of their report, which is entitled "An Economic Assessment of the Exclusive Contract Prohibition Between Vertically Integrated Cable Operators and Programmers," is attached hereto as Exhibit 1. The report is cited hereafter as "Economic Assessment, Ex. 1 at __." The authors of the report conclude that, because "[c]able systems continue to hold an overwhelming share of MVPD

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DISCUSSION

I. Contrary to the Opponents of Extending the Exclusivity Rules, There Is Neither a Presumption in Favor of Sunset, Nor a "Burden of Proof" on Those Advocating Extension of the Rule

The opponents advance two procedural arguments at the outset that are apparently designed to deflect attention away from the weakness of their position on the merits. First, they contend that the statutory language in Section 628(c)(5) creates a "strong presumption" that the exclusivity ban will sunset on October 5, 2002, which can only be overcome by some extraordinary showing of competitive harm.[5] Second, they argue that the "burden of proof" to overcome this presumption rests on the proponents of extending the rule, including, in one version of the argument, both the "burden of production" and the "burden of persuasion."[6] Both of these arguments misconceive the mission Congress has assigned to the Commission and the nature of this proceeding.

The statutory language that governs this issue is simple and straightforward. Section 628(c)(5) provides as follows:

> The prohibition required by paragraph (2)(D) shall cease to be effective 10 years after the date of enactment of this section, unless the Commission finds, in a proceeding conducted during the last year of such 10-year period, that such prohibition continues to be

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subscribers," they would, in the absence of the exclusivity ban, "still have the incentive and ability to harm consumers by foreclosing access to vertically integrated programming to competing MVPD providers." Economic Assessment, Ex. 1 at 31.

[5] *See, e.g.,* AT&T Comments at 3-5; NCTA Comments at 2-4.

[6] *See, e.g.,* AT&T Comments at 6 ("sunset language of Section 628(c)(5) must . . . be interpreted to impose a presumption in favor of expiration, and to shift the burden of proof – both production and persuasion – onto its opponents"); Comcast Comments at 3; AOL Time Warner Comments at 3.

> necessary to preserve and protect competition and diversity in the distribution of video programming.

47 U.S.C. § 548(c)(5); *see also* 47 C.F.R. § 76.1002(c)(6). In effect, Congress has directed the Commission to conduct a proceeding during the period October 5, 2001 through October 4, 2002 to determine whether, in the Commission's view, the exclusivity ban "continues to be necessary to preserve and protect competition and diversity in the distribution of video programming." *Id.* If the Commission determines that the ban continues to be necessary, the ban will remain in effect after October 5, 2002. If the Commission determines that the ban is no longer necessary, it will cease to be effective on that date. Although sunset of the ban is the default option under this statutory scheme, there is nothing explicit (or even implicit) in the statutory language to suggest that Congress intended to create a presumption on the sole question entrusted to the Commission, which is whether the ban continues to be necessary, *given the circumstances that now exist.*[7]

The assertion that the proponents of extending the ban bear some sort of "burden of proof" in this proceeding has even less merit. Concepts like the "burden of production" and the "burden of persuasion" are appropriate in an adjudicatory context, where the Commission is deciding issues for a particular party or parties, and where the factual issues frequently involve

[7] The cases cited by the opponents where particular statutory provisions have been interpreted as creating a presumption are inapposite. Those cases typically involve particularized adjudications. *See, e.g.,* AT&T Comments at 6 n.14 (citing *Panhandle Producers v. Economic Regulatory Agency*, 822 F.2d 1105 (D.C. Cir. 1987) and *Cia Mexicana de Gas, S.A. v. FPC*, 167 F.2d 804 (5th Cir. 1948)). In such an adjudicatory context, creating a presumption in favor of a specified result and placing the burden on the party seeking to avoid that result makes sense. Here, however, the Commission is not being asked to resolve a particularized issue for an individual claimant. Rather, the question is what rule should apply to an entire industry. In that circumstance, the Commission should not create any presumption one way or the other, but should simply decide the issue before it—the continued necessity for the exclusivity ban—in an unbiased way and on the basis of the best evidence and policy judgments available to it.

concrete historical facts. Such notions have no place, however, in a rulemaking proceeding such as this one.[8] Certainly, it behooves all parties to come forward with the best information available to them, so that the Commission can make a fully informed decision. However, it is ultimately the Commission's job to make the judgment that Congress has assigned to it as to whether the exclusivity ban continues to be necessary. Moreover, that judgment must be made not just on the basis of "evidence" in the narrow sense of findings about historical facts, but also on the basis of predictive judgments (*i.e.*, judgments about "legislative facts") of the very type that expert agencies were created to make.[9] To constrain a rulemaking proceeding such as this with inapposite evidentiary rules designed for an adjudicatory context would be inconsistent with the Commission's statutory role, as well as setting a bad precedent for future industry-wide rulemaking proceedings.

Thus, the Commission should approach its task in this proceeding in a straightforward manner, with no thumb on the scale. The mission is simply to make a finding, one way or the other, whether the exclusivity rule continues to be necessary to preserve and protect competition and diversity in the distribution of video programming. If the Commission finds, on the basis of its expert judgment and the evidence available to it, that the exclusivity rule

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[8] As one court has aptly stated: "The opportunity to present and cross-examine witnesses, *a clear allocation of the burden of proof*, and a clear standard against which past conduct is being measured, all of which enhance the adjudication process involving issues of fact are normally either not present or materially different in non-adjudicatory agency proceedings." *International Tel. & Tel. Corp. v. American Tel. & Tel. Co.*, 444 F. Supp. 1148, 1156 (S.D.N.Y. 1978) (emphasis added).

[9] *See, e.g., Cellnet Communications v. FCC*, 149 F.3d 429, 441-42 (6th Cir. 1998) (predictive judgments by agencies entitled to "particularly deferential review"); *accord Melcher v. FCC*, 134 F.3d 1143, 1151 (D.C. Cir. 1998).

is necessary in the MVPD market, the rule should continue in effect, just as Congress intended.[10] As set forth below, EchoStar is confident that, if the Commission considers the relevant facts and circumstances in a fair-minded way, it can reach only one conclusion—that the exclusivity ban *is* necessary to preserve and protect competition and diversity, and indeed that developing competitive challenges to cable would be stopped in their tracks if the exclusivity rule were allowed to sunset.

II. On the Merits, the Ban on Exclusive Contracts Continues to Be Necessary To Preserve and Protect Competition and Diversity

A. Cable Continues to be the Dominant Player in the MVPD Market

A central theme of the opponents is that the ban on exclusive contracts is no longer necessary because the MVPD market has become highly competitive and the conditions of cable market dominance that originally motivated the prohibition have dissipated.[11] The record could not be clearer, however, that the MVPD marketplace continues to be dominated by large, vertically integrated cable operators with both the ability and the incentive to use their control over programming to protect their market power and disadvantage competitive

[10] The fact that some in Congress viewed the exclusivity ban as a "transitional" rule, *see* NCTA Comments at 3-4, is not inconsistent with Congressional intent that the ban should continue beyond the initial 10-year term if the Commission makes the required finding. Indeed, if Congress had intended the ban to sunset after 10 years without regard to conditions in the marketplace, it could have said so explicitly. Instead, it provided for a review in the final year of the 10-year period so that the Commission could assess the current status of the competitive marketplace as it now exists to determine whether the original rule had outlived its usefulness.

[11] *See, e.g.*, AT&T Comments at 16-19; Comcast Comments at 4-7; Cablevision Comments at 20-28; AOL Time Warner Comments at 7-10; NCTA Comments at 4-11.

challengers. Indeed, although competition has grown in the past few years, cable continues to have substantial market power in the MVPD market by any traditional antitrust standard.[12]

In fact, the Commission reached precisely that conclusion in its most recent annual report on the state of competition in the MVPD marketplace: "Cable television still is the dominant technology for the delivery of video programming to consumers in the MVPD marketplace, although its market share is declining."[13] Even the modest decline in cable market share must be put in perspective. The market share of the cable industry nationwide is still in excess of 77%,[14] and is higher still in many individual markets.[15] Moreover, although non-cable alternatives, including DBS, are growing (and in some cases growing rapidly), they have not yet succeeded in constraining the market dominance of the incumbent cable operators.[16] In fact, as more and more cable systems introduce digital cable, thereby expanding both the number of channels offered and the capability to provide bundled broadband service, the ability of DBS to

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[12] *See* Economic Assessment, Ex. 1 at 15-20.

[13] *In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Seventh Annual Report, 16 FCC Rcd. 6005 (rel. Jan. 8, 2001) (hereafter "Seventh Annual Report") at ¶ 5.

[14] *See* Comments of NCTA in response to 2001 Notice of Inquiry, at 7 (dated Aug. 2, 2001).

[15] Under traditional antitrust standards, a market share in excess of 50% raises concerns about monopoly power, and a market share over 70% is often equated with monopoly power. *See Broadway Delivery Corp. v. United Parcel Serv. of Am., Inc.*, 651 F.2d 122, 129 (2d Cir. 1981) (firm with market "share between 50% and 70% can occasionally show monopoly power, and a share above 70% is usually strong evidence of monopoly power"); *accord Am. Council of Certified Podiatric Physicians and Surgeons v. Am. Bd. of Podiatric Surgery, Inc.*, 185 F.3d 606, 623 (6th Cir. 1999).

[16] Economic Assessment, Ex. 1 at 15.

constrain the market power of cable is likely to be further reduced unless DBS can recover the lost ground.[17]

The continued ability of cable operators to raise prices at a rate exceeding general inflation is strong evidence that they are still able to exert substantial market power despite the existence of various non-cable alternatives.[18] Indeed, just last month, Adelphia Communications Corp. announced rate increases for many of its cable television subscribers in Palm Beach and Miami-Dade County, Florida that will take the rate for expanded service (which some 98 percent of Adelphia's South Florida customers reportedly elect) from \$36.35 per month to \$41.35 per month, an increase of almost 14%.[19] The ban on exclusivity, by ensuring comparability of program offerings as a prerequisite for effective competition, is necessary to promote greater direct price competition and thereby avoid the need for burdensome cable rate regulation at the retail level. This effect is consistent with congressional and Commission policies favoring competition over regulation to the extent possible.[20]

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[17] Economic Assessment, Exh. 1 at 16.

[18] *See State of Competition in the Video Marketplace: Hearing on Cable and Video: Competitive Choices, Before the Senate Committee on the Judiciary, Subcommittee on Antitrust, Business Rights and Competition*, 107th Cong. (Apr. 4, 2001) (prepared testimony of the Cable Services Bureau, FCC) (citing the Commission's 2000 Annual Report on Cable Industry Prices, 16 FCC Rcd. 4346 (2001)).

[19] *See* Joseph Mann, "Adelphia to boost cable TV rates in Palm Beach, Miami-Dade," *South Florida Sun-Sentinel*, December 20, 2001.

[20] *See Implementation of Sections 12 and 19 of the Cable Television Consumer and Protection Act of 1992, First Report and Order,* 8 FCC Rcd. 3359, 3369 (rel. Apr. 30, 1993) ("Our regulations regarding program access are designed . . . in a manner that is faithful to the policy of Congress to . . . rely on the marketplace, to the maximum extent feasible ...."); *see also FCC Commissioner Michael Powell Advises Investment Analysts to Look for Evidence of Regulators Promoting Innovation and Competition,* FCC News Release (Mar. 13, 1998),

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As further evidence of cable's dominance in the MVPD market, the recently announced agreement between EchoStar and Vivendi-Universal ("Vivendi") illustrates that MVPDs without market power do not have the same ability or incentive to enter exclusive distribution agreements with programmers. Specifically, in exchange for its investment in EchoStar, Vivendi will receive, among other things, the ability to place five new channels on EchoStar's system.[21] In contrast to cable operators' exclusive sports programming arrangements, however, the EchoStar/Vivendi agreement is *non-exclusive* and expressly requires Vivendi to gain an equal amount of carriage for the new networks on third-party platforms within three years. As one investment analyst observed, the agreement represents an attempt by EchoStar to better compete against cable.[22]

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available in 1998 WL 110174 (announcing a "new regulatory thinking" that favors free market competition in communications).

[21] Under the agreement, Vivendi will make a $1.5 billion investment in EchoStar and will receive a minority equity stake and a board seat. Vivendi's economic interest in ECC is expected to amount to less than 10% on a fully diluted basis, based on the number of shares outstanding on December 14, 2001, and the voting stake will be smaller still at about 2%, before the merger with Hughes is consummated. Upon EchoStar's proposed merger with Hughes Electronics, these percentages will further decrease to less than 5% equity interest and about 1% voting interest in the new EchoStar Communications Corporation. As part of the transaction, ECC has also agreed to carry five new Vivendi channels and to make available the equivalent of about eight video channels on its system for new interactive services, such as interactive games, movies, sports, education and music services; to deploy non-exclusively certain "middleware" technology on some set-top boxes; to facilitate interactive services; and to carry Vivendi films and music on a pay-per-view basis. *See Letter pursuant to 47 C.F.R. § 1.65 notifying the Commission of the Definitive Agreement with Vivendi Universal S.A. Filed by Echostar, General Motors Corporation and Hughes Electronics Corporation* (Dec. 18, 2001), *available at* http://www.fcc.gov/transaction/echostar-directv/echostar_ltr121801.pdf.

[22] COMMUNICATIONS DAILY, Vol. 21, No. 242 (December 17, 2001) at 3 (quoting an unnamed analyst as saying, "Charlie [Ergen] is showing people he is serious about becoming a strong competitor to cable. This deal moves him closer to his goal.").

Under the logic espoused by the cable industry in this proceeding, it presumably would have been in EchoStar's and Vivendi's economic interests to pursue an exclusive arrangement. Not so. First, unlike cable, EchoStar does not have the economic power to attain such programming exclusivity. In a national market dominated by cable's nearly 80% market share, a programmer would have trouble surviving on EchoStar, or for that matter DBS, alone. Even if EchoStar is permitted to merge with Hughes Electronics, the combined entity would have trouble sustaining by itself a new network on a subscriber base of approximately 15 million. Moreover, a programmer that enters a DBS-exclusive carriage agreement may find itself subject to the cable industry's collective retribution when it seeks cable carriage for its other properties.

Second, in the absence of MVPD market dominance, non-exclusivity generally presents programming entities such as Viviendi with a greater return on investment. Vivendi's new networks will be stronger economically when distributed as widely as possible, instead of on just a DBS platform. Exclusivity would have posed a cost to Vivendi and, since Vivendi is not a vertically integrated MVPD, it would have had no countervailing economic benefit in the form of better subscriber acquisition. A cable operator, by contrast, is more likely to assume the cost of diminished distribution in exchange for undermining competing MVPDs.[23]

In short, as the attached Economic Assessment concludes, "Despite claims that the structure of the MVPD market has changed enough to make foreclosure unprofitable, cable firms are still dominant in the market and the fundamental motivation for the prohibition therefore has not significantly changed."[24]

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[23] *See* Economic Assessment, Ex. 1 at 24 n.58.

[24] Economic Assessment, Ex. 1 at 17 (footnote omitted).

B. The Market Power of Major MSOs and Their Vertical Integration With Video Programmers Create a Situation Rife With the Threat of Anti-Competitive Conduct

A number of the opponents argue that the Commission should terminate the ban on exclusive contracts because such contracts are economically efficient and, in effect, should never have been prohibited in the first place.[25] The theory is that video programmers would have economic incentives to offer exclusivity to certain downstream distributors even in a perfectly competitive market, because the competitive advantage to the downstream distributor from offering the program on an exclusive basis is sufficient to permit that distributor to compensate the programmer for giving up the right to reach additional consumers through other distribution channels.[26] The opponents go on to give numerous examples of circumstances in which exclusive arrangements exist in competitive markets, suggesting that these contracts must be equally benign in the MVPD market context.[27]

This contention is simply wrong, and misconceives the basis on which Congress enacted the exclusivity ban in the first instance. No one contests that exclusive contracts can, in appropriate circumstances, be economically beneficial. The issue here is whether the particular market circumstances that led Congress to conclude that these arrangements had an unduly negative effect on competition in the MVPD market have changed significantly since 1992. The

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[25] *See, e.g.,* AT&T Comments at 6-13; Comcast Comments at 9-13; AOL Time Warner Comments at 14-18; Cablevision Comments at 5-10.

[26] *See, e.g.,* "Competition for Video Programming: Economic Effects of Exclusive Distribution Contracts," Economists Incorporated, Dec. 3, 2001, attached to Cablevision Comments (hereafter cited as "Economists Inc. Report").

[27] *See, e.g.,* Cablevision Comments at 6-7; AT&T Comments at 8-10.

answer clearly is no. Cable operators still have much the same degree of market power in the distribution market, and virtually the same degree of influence in the video programming market, that they had when the ban was first imposed.[28] Indeed, in some respects, the power of the largest cable companies has been substantially enhanced because, through consolidation and clustering, a handful of MSOs now control a very high percentage of cable systems nationwide.[29]

As a result of their dominant market position, cable operators can leverage their influence over video programmers to "lock up" popular or desirable programming to the detriment of consumer welfare. According to the Economic Assessment attached hereto:

> Some commentators have indicated that cable firms will have no incentive to use exclusive contracts to foreclose competition. Such a perspective, however, is inconsistent with current economic

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[28] As noted in the attached Economic Assessment, although the opponents argue that the percentage of vertically integrated programming services has declined, it is important to note that much of the most popular cable programming continues to be vertically integrated. *See* Economic Assessment, Ex. 1 at 18.

> For example, according to the FCC, four of the top six for-profit video programming networks ranked by subscribership are vertically integrated with a cable provider. In addition, three out of the top five video programming networks ranked by prime-time ratings are vertically integrated with cable firms. These top channels (e.g., TBS, USA, TNT) are critically important to DBS firms in offering a viable alternative to cable providers.

Id. (footnotes omitted).

[29] Economic Assessment, Ex. 1 at 19-20. As noted in the attached Economic Assessment, in 1995, the top ten cable systems accounted for less than 60 percent of all cable subscribers nationwide. Today, the top ten cable operators serve almost 90 percent of U.S. cable subscribers, and the degree of cable concentration will increase further if the pending merger of the cable operations of AT&T and Comcast is approved and implemented. *Id.* at 20. This concentration is important because "the larger the size of the integrated cable firm's potential subscriber base, the larger the potential benefit from foreclosing access to programming." *Id.* at 19.

> theory. It is also belied by two facts: first, when allowed to do so, cable systems have demonstrated a willingness to engage in foreclosure (e.g., Comcast's SportsNet in Philadelphia); and second, the strength of the cable industry's effort to lift the prohibition raises questions about the motivation for that effort.[30]

The effect of such foreclosure is clear: "If a cable firm is able to lock in subscribers, the firm increases its power to raise prices. Such pricing power can thus be used to adversely affect consumers in the future."[31]

An excellent real world example of this use of exclusive contracts to disadvantage rivals and harm consumers is provided by the actions of Comcast with respect to local sports programming in Philadelphia. As described in the Economic Assessment (Ex. 1), Comcast has exploited an arguable loophole in the exclusivity ban (*i.e.*, the Commission's failure to apply it to cable programming delivered by terrestrial means) to "lock up" the rights to show key local and regional sports programming broadcast by its SportsNet affiliate.[32] The effect on the market has been dramatic: "While many factors can influence the DBS penetration rate in a particular market, the lack of regional sports programming appears to have reduced DBS subscribership in Philadelphia."[33] For example, "the DBS penetration rate in Philadelphia is by far the lowest of the top 20 cities in the United States," with Philadelphia at just 3.9 percent, compared with an average of 9.3 percent among the top 20 cities.[34] Indeed, one local Philadelphia broadcast station

[30] Economic Assessment, Ex. 1 at 5.

[31] Economic Assessment, Ex. 1 at 23 n.54. While vertical integration facilitates this type of anti-competitive conduct, it is also possible for programming to be "locked up" even in the absence of vertical integration.

[32] Economic Assessment, Ex. 1 at 22.

[33] Economic Assessment, Ex. 1 at 22.

[34] *Id.* at 23 (citing Forrester Research, Inc., Technographics Benchmark Survey, 2001).

recently contended that Comcast uses its local sports programming to hamper competition by refusing to make SportsNet available to satellite-TV providers. The Philadelphia Inquirer quoted the president and general manager of WPVI in Philadelphia as saying SportsNet "is a key part of their [Comcast's] strategy to monopolize this market."[35] The Philadelphia experience is thus a good barometer both of the incentives for dominant cable operators to use exclusive contracts to foreclose competition, and also the detrimental effects of such activities.

In response, the opponents make two somewhat contradictory arguments. On the one hand, some of the opponents contend that, in the absence of the ban, they can (and presumably will) lock up desirable programming through exclusive contracts, but that this is a good thing because it will spur competitors to create their own alternative programming in the quest for economic survival.[36] Other opponents contend that permitting the ban to expire will have only a small effect on competition because cable operators have little incentive to seek exclusivity, and will therefore rarely foreclose programming from competing MVPDs.[37]

Obviously, these arguments cannot both be correct. More importantly, in the current context, neither is applicable. With respect to the argument that exclusive contracts are

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[35] Economic Assessment, Ex. 1 at 22 n.54 (citing Patricia Horn, "As Competition Lags for Cable TV, Prices Tend to Rise," *Philadelphia Inquirer*, June 3, 2001, p. E01). The same article quoted a DIRECTV spokesman as saying with respect to Philadelphia: "We clearly don't have the same kind of success in getting customers in that area as we have in other similar markets, due to this issue with Comcast. These SportsNets are like local channels. They are part of a local package that is essential for us to be fully competitive with cable." *Id.* at 23 n.56

[36] *E.g.,* Cablevision Comments at 15-18; Comcast Comments at 9-11.

[37] *E.g.*, AT&T Comments at 23-24; AOL Time Warner Comments at 10 ("Even without an exclusivity restriction, there are powerful economic incentives for AOLTW to provide its popular cable networks to the widest possible audience.").

beneficial and should be encouraged, the attached Economic Assessment explains in detail why, in the context of the MVPD market, this argument is wrong. Most significantly, "[m]aintaining the prohibition on exclusive contracts for video programming among vertically integrated cable firms attenuates the potential for anti-competitive behavior."[38] Thus, the need for the ban on exclusivity remains as strong today as it has ever been.

The second contention—that cable operators have little incentive or ability to use exclusive contracts to foreclose competition—is equally incorrect. First, if this contention were true, it is not apparent why the cable industry would be spending valuable time and resources arguing for the termination of the exclusivity ban. Second, the argument is based on an inapplicable economic model that assumes a fully competitive market, rather than the real world MVPD market that is plainly dominated by cable. Certainly, in a fully competitive market, video programmers and MVPDs alike would have little incentive to enter into exclusive arrangements, because the economics of the industry drive the programmer to seek the widest possible audience whenever possible. In fact, that is precisely the prevailing practice of non-affiliated programmers: exclusive deals involving programmers that are not affiliated with cable systems are the exception rather than the rule, raising at least some suspicion about the motives of those commenters who are so ardently interested in the ability to reach exclusive deals.[39] As discussed above, non-exclusivity (and indeed an incentive for broad distribution) is also the dynamic operating in the recently announced EchoStar-Vivendi arrangement.

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[38] Economic Assessment, Ex. 1 at 25.

[39] *See* Economic Assessment, Ex. 1 at 23 & n.58.

However, the MVPD market is anything but a fully competitive arena. Opportunities for abuse of market power abound, owing to the dominant position occupied by the cable operators. Contrary to the economic report attached to the Cablevision Comments,[40] the incentives of cable operators to enter into competitively harmful exclusive contracts are significantly different from those that would exist in a fully competitive world.[41] Moreover, it is no defense to argue that the downstream cable operators already have market power and could exercise it in the absence of exclusivity. There can be no doubt that the ability to withhold desirable programming from alternative MVPDs is a powerful tool that both facilitates and enhances the exercise of the market power cable operators already possess.[42]

As a result, continuing the ban on exclusive contracts in this specific circumstance (*i.e.*, video programmers aligned in interest with market dominant cable operators) makes sense, notwithstanding that exclusive contracts are permitted, and even encouraged, in some other contexts. Cablevision, for example, cites to the example of the exclusivity rights granted to local broadcasters against duplicate programming imported via distant signals.[43] Putting to one side the question whether exclusivity is economically justified in that context,[44] the situations are so

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[40] *See* Economists Inc. Report, *supra* note 26.

[41] Economic Assessment, Ex. 1 at 11.

[42] *See* Economic Assessment, Ex. 1 at 15.

[43] Cablevision Comments at 10, citing *In the Matter of Amendment of Parts 73 and 76 of the Commission's Rules Relating to Program Exclusivity in the Cable and Broadcast Industries, Report and Order*, 3 FCC Rcd. 5299 (1988) ("*Syndicated Exclusivity Order*").

[44] History suggests that the protection of exclusivity in that context arose more from a concern with preserving the viability of local broadcasters than because of the economic efficiencies or benefits of exclusivity, per se. *See Syndicated Exclusivity Order*, at ¶ 9:

(Continued ...)

different that the suggested analogy must fail. In the syndicated exclusivity context, the cable operator (and indeed any other MVPD) is still permitted to transmit the programming itself; it is simply prohibited from importing duplicate programming from a distant source. This is a sharp contrast to the cable exclusivity context, where the MSOs are seeking the ability to deny competing MVPDs *any* access to certain programming, not just access from a duplicate source. The effect of such exclusivity, if permitted, would be to deny the viewers of those competing MVPDs the ability to see the affected programming *at all* unless those viewers are coerced into switching to cable for their video distribution service (or elect to pay the cost of two MVPD providers). As discussed in the attached Economic Assessment, "exclusivity for programming on the broadcast networks (e.g., ABC, NBC, and CBS) does not require viewers to adopt the

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> Thus, at this stage of cable's development the Commission was principally concerned that cable's growth not endanger these allocation schemes and the economic viability of local broadcast television. In order to protect these schemes, the Commission concluded that the public interest required more than mediation among those desiring to provide service to the public. Rather, it required, in the Commission's view, exercising a firm administrative grip on the development of cable. This outlook led to a regulatory regime the first part of which required carriage of local signals. In the second prong of its policy, the Commission sought to identify those signals a cable system could carry without threatening the continued financial viability of individual local broadcasting stations within the system's service area. The Commission had concluded that cable systems' importation of distant signals to duplicate such programming was an unfair method of competition. Thus, among the rules adopted at this time were uniform non-duplication rules to protect both network programming and syndicated programming for which local broadcasters had negotiated exclusive exhibition rights. The basic principle applied was that non-duplication benefits were "something to which a station is entitled, without a showing of special need, within its basic market area."

entire bundle of broadcast programming in order to view the exclusive programming."[45] For example, "if NBC has an exclusive right to broadcast the Olympic Games, a viewer would have to watch NBC to see the events. But the viewer does not have to switch to NBC to watch all other 'over-the-air' programming. By contrast, if NBC were carried on cable systems and not on DBS systems, the viewer would have to switch all programming from DBS to cable (or incur the added cost of subscribing to both DBS and cable) in order to view the Olympics."[46]

Similarly, the very limited exclusive arrangements entered into by DIRECTV and EchoStar are in no way comparable to the types of exclusivity sought by the cable MSOs. The opponents of extending the ban are simply wrong in suggesting that DIRECTV's NFL Sunday Ticket is exclusive as against cable or other non-DBS MVPDs.[47] The exclusivity is against any other DBS provider providing the same programming.[48] Because it is neither dominant in the overall distribution market, nor vertically integrated with video programmers,[49] EchoStar lacks

[45] Economic Assessment, Ex. 1 at 13.

[46] Economic Assessment, Ex. 1 at 14.

[47] *See* iN DEMAND Comments at 11; NCTA Comments at 10; Cablevision Comments at 7-8; AT&T Comments at 9.

[48] *See* Economic Assessment, Ex. 1 at 23 n.58. Notably, if and when the EchoStar-Hughes merger is approved, this exclusivity provision will become moot.

[49] Even after the EchoStar-Vivendi transaction, it is the video programmer (Vivendi) that will own a small (and non-controlling) interest in the MVPD (EchoStar), not the other way around as in the cable context. (Three years after the transaction closes, EchoStar could exercise an option to acquire a 10% stake in the programming networks involved. Unless and until that happens, however, EchoStar holds no equity interest in the networks.) Moreover, to the extent EchoStar's subsidiary Kelly Broadcasting Systems, Inc. ("Kelly") has obtained exclusive distribution rights for certain foreign language networks (*e.g.*, Greek, Russian, Arabic), it did so through arm's length negotiations with foreign programmers, not through acquisition of control over these programmers. Furthermore, those rights mean only that other U.S. distributors must deal with Kelly (as opposed to the foreign content providers) with respect to this programming.

both the incentives and the ability to enter into anti-competitive exclusivity arrangements excluding all cable systems. As the attached Economic Assessment concludes:

> For an independent programmer to be willing to enter into an exclusive contract with an MVPD firm, the MVPD firm must be willing to compensate the programmer for forgoing the revenue from all other MVPD outlets in the region covered by the contract . . . . Since cable firms account for nearly 80 percent of the MVPD market, it is unlikely that a non-cable MVPD provider would find it profitable to engage in such an exclusive arrangement.[50]

In short, the opponents are making a "wolf in sheep's clothing" argument. They are seeking to analogize themselves to economically benign forms of exclusive distributorship contracts that prevail in other contexts, without recognizing that their dominant position makes those analogies inapt. Again, the question the Commission must answer is whether the exclusivity ban *in this particular market* continues to be necessary because the conditions that led to that ban continue to apply. Showing that exclusivity is not prohibited in other markets with other economic characteristics contributes nothing to that exercise.

C. Reliance by the Opponents on the Existence of Competition in the Upstream Video Programming Market Is Misplaced

Recognizing that the inevitable effect of permitting exclusive contracts between cable operators and vertically integrated video programmers will be to foreclose competing MVPDs (and their viewers) from access to desirable programming, a number of the opponents argue that no harm will arise from this foreclosure because the upstream video programming

[50] Economic Assessment, Ex. 1 at 24 n.58.

market is highly competitive.[51] Under this theory, competitors like EchoStar that are denied access to desirable cable networks like HBO or CNN can simply go to the video programming market and obtain substitute programming that will prevent consumers from migrating to cable to see their favorite programs. Thus, it is asserted, the Commission need not fear any competitive harm arising from permitting the exclusivity ban to sunset.

Like many of the opponents' economic theories, this one may apply in a perfectly competitive market, but it bears little resemblance to the real world of video program distribution. In a perfectly competitive environment, if one distributor "locks up" a particular brand of widget through an exclusive distribution contract, other distributors simply go to alternative suppliers of widgets and are fully able to compete in the ordinary way. Thus, so long as the upstream supply market is competitive, there is no threat to consumer welfare from an exclusive distribution agreement. However, contrary to the implication of the opponents' arguments, video programming is not a fungible good like widgets. It is a highly differentiated product for which, in many cases, there simply are no good substitutes available.

In the case of certain programming networks (*e.g.*, "marquee" networks like HBO or CNN), the inability of a non-cable MVPD to carry those networks may by itself cause consumers to forgo lower prices in favor of switching to cable, notwithstanding that many other less-popular channels are still available. Moreover, even with respect to networks that do not fall in the "must-have" category on their own, the availability of a full range of programming can be sufficiently important to consumers that denial of a number of minor channels would likewise constitute an insuperable obstacle to mounting a successful competitive challenge to cable. In

[51] *See* Cablevision Comments at 30-31, 35-37; AT&T Comments at 19-22.

fact, empirical evidence shows that consumers value most highly the ability to view the greatest number of channels available, which makes almost any significant degree of exclusivity problematic for cable competitors.[52] In fact, as the Philadelphia example demonstrates, even the unavailability of a small portion of the overall programming available (in that case, regional sports telecasts) can have a profound effect on DBS penetration rates.[53]

III. Extending the Exclusivity Ban Will Not Significantly Reduce the Incentives to Create New Or More Diverse Programming, and In Fact Will Preserve and Protect Diversity, as Articulated in the Statute

Another theme of the opponents' comments is that the exclusivity ban allegedly reduces the incentives of cable operators to create or support new or more diverse programming.[54] The apparent theory is that cable operators will not invest in new programming that they hope will be successful in the marketplace unless they can expect to reap the benefits of exclusivity if the programming is successful. Related to this theory is the contention that non-cable MVPDs benefit from a "free rider" effect and therefore lack the incentive to create their own programming.[55] Again, these contentions do not reflect the realities of the video distribution marketplace, and in any event do not undermine the case for extending the current

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[52] *See* Economic Assessment, Ex. 1 at 26 ("recent survey of new DBS subscribers found that the leading reason for switching to DBS was 'more channels'").

[53] Economic Assessment, Ex. 1 at 22-24.

[54] *E.g.*, AT&T Comments at 10-11; Cablevision Comments at 2, 14-15; NCTA Comments at 17.

[55] *E.g.*, AT&T Comments at 8, 12; Comcast Comments at 10; Cablevision Comments at 9, 15.

exclusivity rules. In fact, the exclusivity ban is completely consistent with preserving and protecting program diversity, which is an express goal of the statute.[56]

With respect to the alleged discouragement of new or diverse video programming, it should suffice to point out that, over the ten-year period in which the exclusivity ban has been in effect, the quantity and diversity of video programming available has literally exploded. "Since 1992," the attached Economic Assessment notes, "the number of national programming channels has increased 223 percent, from 87 in 1992 to 281 in 2001."[57] Moreover, the driving factor behind this explosive growth has not been exclusivity (which is generally prohibited under the existing rules for cable-affiliated programmers and exceedingly rare for non-affiliated ones), but the demand by consumers for an ever-increasing range of choices, combined with the technological ability to offer additional channels. The contention that a ban on exclusivity has had any significant negative effect (or will in the future have any significant negative effect) on the incentives to create desirable new programming is questionable in the extreme.

Because of the DBS competition made possible by the exclusivity ban, cable firms have been pressured to invest in additional channel capacity. As stated by NCTA President and CEO Robert Sachs:

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[56] The statute's explicit reference to "diversity" here contrasts with more general statutory references to the "public interest" that the Commission has traditionally read to include a "diversity" component. *1998 Biennial Regulatory Review -- Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996,* 15 FCC Rcd. 11058 (¶8 & n.16) (rel. June 20, 2000). By requiring the Commission to examine diversity in this proceeding, Congress has eliminated any doubt that it sought to maintain a plethora of voices in the marketplace.

[57] Economic Assessment, Ex. 1 at 25 (citing NCTA Comments at 12).

> Being digital from the start, and having the advantage of a substantially greater channel capacity, DBS spurred cable operators to replace hundreds of thousands of miles of coaxial cable with fiber optics so that they too could offer consumers hundreds of channels of digital video and audio services.[58]

Moreover, "the DBS firms have played an important role in providing a launch platform for independent programmers."[59] Indeed, EchoStar's recent agreement with Vivendi "illustrates how an MVPD programmer can facilitate the entry of new programming on a non-exclusive basis."[60]

The pending merger between EchoStar and Hughes (DIRECTV) opens up further opportunities to enhance programming diversity. As described in the attached Economic Assessment:

> The proposed merger of EchoStar and DIRECTV could eventually "free up" roughly half of the current spectrum used by the individual firms, thus allowing the new EchoStar to increase the number (and diversity) of channels offered to subscribers. Given the preference of MVPD subscribers for "more channels," such an expansion of channel capacity would likely force cable systems to continue to upgrade their program offerings. With more channel capacity on both DBS and cable, programming diversity will likely expand.[61]

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[58] Economic Assessment, Ex. 1 at 26 (quoting Robert Sachs, Testimony Before Subcommittee on Antitrust, Business Rights and Competition, Committee on the Judiciary, United States Senate, April 4, 2001, pages 2-3).

[59] Economic Assessment, Ex. 1 at 26.

[60] *Id.* at 26-27.

[61] *Id.* at 27 (footnotes omitted).

Tellingly, the opponents cite very few concrete examples of specific program offerings that have been discouraged or prevented by the exclusivity ban.[62] Once again, this suggests an area where the alleged problem exists more in the world of economic theory than in the real world. Moreover, even if there are examples of such programming, the opponents have shown no reason why those few examples could not be readily accommodated through the existing waiver procedure, without incurring the substantial anti-competitive harm of having no rule at all. The argument that the existing procedure is unduly cumbersome or unworkable is belied by the facts. Of six petitions filed since 1992, two were granted, and in most cases the decision was issued within a few months of the notice of filing of the petition. Moreover, the proceedings are typically conducted on a paper record (*i.e.*, without a live hearing), and the statute specifically provides for an expedited decision.[63] As the attached Economic Assessment concluded, therefore: "This record simultaneously demonstrates that the FCC is willing to grant exemptions when exclusive contracts are in the public interest, and also that exclusive contracts are generally not in the public interest (especially since the number approved is relatively low despite the fact that the most auspicious cases were the ones presumably filed)."[64] In any event, the desire to promote new forms of video programming in no way justifies the real aim of the

[62] *See* iN DEMAND Comments at 14-15. iN DEMAND's Comments refer to a one-time rock concert and a potential sports programming package as examples of programs that allegedly did not get produced because of the inability to provide exclusivity. *Id.* However, it is not clear from the comments exactly what role exclusivity (as opposed to other factors) played in these decisions.

[63] *See* 47 U.S.C. § 548(f) ("The Commission's regulations shall * * * provide for an expedited review of any complaints made pursuant to this section."); *see also In re Cable Television Consumer and Competition Act of 1992,* 8 FCC Rcd. 3359, 3416 (rel. Apr. 30, 1993).

[64] Economic Assessment, Ex. 1 at 30.

opponents, which is to deny access to already-existing name-brand video programming as a tool for suppressing competition from DBS and other non-cable MVPDs.

Moreover, the EchoStar/Vivendi agreement described above in Section III.A should remove any doubt about the DBS industry's incentive to participate in the development of programming, albeit on a non-exclusive basis. Under the agreement, new programming and services developed by Vivendi will be available to EchoStar subscribers. EchoStar entered this agreement despite the existing ban on exclusivity in the cable context, reflecting the market reality that, even with access to programming thanks to provisions of law, EchoStar remains engaged in an uphill battle against cable operators and must continue to innovate in order to compete. Agreements like the one between EchoStar and Vivendi are necessary but not sufficient to achieve full competition. Allowing the exclusivity ban to sunset would pose a severe setback in this competitive landscape.[65]

IV. There Is No First Amendment Barrier to Extension of the Existing Exclusivity Rule

Finally, at least two of the opponents assert that extension of the existing exclusivity rule would violate the First Amendment.[66] Essentially, their argument is that the prohibition on exclusive contracts, although facially neutral, has a "chilling effect" on speech because it discourages creation of new programming by vertically integrated video

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[65] The opponents have not established that the general antitrust laws are a suitable substitute for the exclusivity rule. *E.g.*, Cablevision Comments at 37-39. For all of the reasons discussed in EchoStar's original comments, the general antitrust laws are simply too blunt an instrument to be useful for this purpose. *See* EchoStar Initial Comments at 15-18.

[66] *See* AOL Time Warner Comments at 4-6; Cablevision Comments at 40-41.

programmers.[67] As discussed further below, there are two fundamental problems with asserting this argument in the present context. First, the D.C. Circuit has already rejected a facial challenge to Section 628 of the Communications Act on precisely the grounds asserted here.[68] Second, even if the First Amendment issue were not settled as a result of the D.C. Circuit's prior ruling, the issue raised here is not the constitutionality of any action of the FCC, but the constitutionality of the statute itself, which is the type of issue the Commission has traditionally left to the courts to resolve. Thus, the alleged First Amendment issue presents no obstacle to the Commission's extension of the exclusivity rule if it determines that the statutory standard is met.

With respect to the D.C. Circuit's prior ruling, that case arose when AOL Time Warner's predecessor—Time Warner Entertainment Co.—brought a First Amendment challenge to Section 628(c)(2)(D), which is the provision of the 1992 Cable Act that originally required the Commission to impose the exclusivity ban. On review of the district court, the D.C. Circuit first held that the provisions of Section 628, including the exclusivity ban, were "content-neutral on their face, regulating cable programmers and operators on the basis of the 'economics of ownership,' a characteristic unrelated to the content of the speech."[69] Applying the intermediate

[67] *Id.* AOL Time Warner also advances an argument that the ban "coerces speech," and is therefore subject to strict scrutiny, because it allegedly mandates "that cable-affiliated programmers must distribute their programming through parties not of the programmer's choosing." AOL Time Warner Comments at 4. Nothing about the exclusivity ban "coerces speech," however. The rule applies only to speech that the video programmer has voluntarily created and voluntarily chosen to distribute to the public. From the standpoint of the video programmer, the only effect of the prohibition is to encourage more speech, by facilitating even broader distribution of the same message. Nor is any MVPD required to carry particular programming against its will.

[68] *See Time Warner Entertainment Co. v. FCC*, 93 F.3d 957 (D.C. Cir. 1996).

[69] *Time Warner*, 93 F.3d at 977, quoting *Daniels Cablevision, Inc. v. United States*, 835 F. Supp. 1, 7 (D.D.C. 1993).

scrutiny standard of First Amendment review, the court then went on to sustain the exclusivity rule against the claim that it was not "narrowly tailored" because it burdened more speech than was necessary to further the government's legitimate interest.[70] In particular, the court held that the "government's interest in regulating vertically integrated programmers and [cable] operators is the promotion of fair competition in the video marketplace," *id.*, and that this goal "both furthers an important government interest and is unrelated to the suppression of free expression." *Id.* It also noted that "Congress considered Time Warner's argument and concluded that the benefits of these provisions – the increased speech that would result from fairer competition in the video programming marketplace – outweighed the disadvantages – the possibility of reduced economic incentives to develop new programming." *Id.* The opponents in this case are essentially repeating the same arguments against precisely the same rule that was upheld by the D.C. Circuit as recently as 1996. There is absolutely no reason to believe that the extension of the existing rule beyond October 5, 2002 would lead to any different result under the First Amendment.

Moreover, even if the constitutional issues were still open for debate, it has been this Commission's practice to leave to the judiciary questions regarding the constitutionality of congressional enactments the Commission is called upon to apply.[71] Unlike the cases cited by

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[70] *Time Warner*, 93 F.3d at 978.

[71] *See, e.g., In re: Petition of Cablevision Systems Corporation for Modification of the ADI of Television Broadcast Stations WTBY, WRNN, WMBC-TV and WHAI-TV*, 11 FCC Rcd. 6453 at ¶ 43, n.40 (rel. May 31, 1996) (constitutionality of 1992 Cable Act's must-carry provisions pending before federal court; in the absence of a stay, "Cablevision's challenge to the constitutionality of the rules is inappropriate here").

the opponents,[72] this is not a case where the Commission is independently fashioning a rule of its own and therefore arguably must consider constitutional defenses to its own "'self-generated' policy."[73] Rather, this is simply a case of the Commission extending a congressionally-enacted rule if, but only if, it makes the finding specified in the statute Congress enacted.[74] Nothing about this situation suggests that the Commission is expected to, or should, independently evaluate the constitutional merits of the exclusivity ban Congress chose to adopt.

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[72] *See, e.g.,* Cablevision Comments at 41 & n.125.

[73] *Syracuse Peace Council v. FCC*, 867 F.2d 654, 656 (D.C. Cir. 1989); *see also Graceba Total Communications, Inc. v. FCC*, 115 F.3d 1038, 1041-42 (D.C. Cir. 1997) ("The Commission has an obligation to address properly presented constitutional claims which . . . *do not* challenge agency actions mandated by Congress.") (emphasis added).

[74] In other words, the statute clearly contemplates that if the Commission finds that the exclusivity ban "continues to be necessary" based on the marketplace conditions in the final year of the ten-year period, then the existing congressionally-imposed rule will continue to operate beyond October 5, 2002.

CONCLUSION

For the reasons set forth above and in EchoStar's initial comments, the Commission should exercise its authority to extend the existing prohibition on exclusive contracts for affiliated video programming.

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AN ECONOMIC ASSESSMENT OF THE EXCLUSIVE CONTRACT PROHIBITION BETWEEN VERTICALLY INTEGRATED CABLE OPERATORS AND PROGRAMMERS

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About This Report

This report was commissioned by EchoStar Satellite Corporation and DIRECTV, Inc., as an independent analysis of the economic issues associated with the Federal Communications Commission's notice of proposed rulemaking as to whether to sunset the exclusive programming contract prohibition (see the Federal Communications Commission Notice of Proposed Rulemaking in the Matter of Implementation of the Cable Television Consumer Protection and Competition Act of 1992, Development of Competition and Diversity in Video Programming Distribution: Section 628(c)(5) of the Communications Act: Sunset of Exclusive Contract Prohibition).

The views and opinions expressed in this report are solely those of the authors and do not necessarily reflect the views and opinions of EchoStar Satellite Corporation and/or DIRECTV, Inc. They should not be attributed to the staff, officers, or trustees of the Brookings Institution or any of the other organizations with which the authors are or have previously been associated.

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The curriculum vitae for the authors are attached as Appendix 1.

Table of Contents

Executive Summary

- Economic theory suggests that vertical integration and exclusive contracts can be used to increase efficiency, but can also be used for anticompetitive purposes. A key determinant of whether vertical integration and exclusive contracts can be used for foreclosure is the degree of market power: anticompetitive exclusivity is possible in markets that are not fully competitive.

- Although competition in the multi-channel video programming distribution (MVPD) market has improved since the early 1990s, the Federal Communications Commission (FCC) recently stated that cable television "still is the dominant technology for the delivery of video programming to consumers in the MVPD marketplace." Despite Direct Broadcast Satellite (DBS) subscriber growth, cable firms provided service for more than 77 percent of all MVPD subscribers in July 2001. With the introduction of digital cable, DBS' traditional competitive advantage of higher quality and more channel capacity may fade and the market power of cable firms may well increase.

- One of the premises of the exclusive contract prohibition was that cable firms had significant power in the MVPD market. Despite claims that the structure of the MVPD market has changed enough to make foreclosure unprofitable, cable firms are still dominant in the market and the fundamental motivation for the prohibition therefore has not significantly changed – especially given the trend toward horizontal consolidation in the cable industry and the introduction of digital cable.

- In order to offer a viable alternative to cable firms, non-cable MVPD providers must provide the programming produced by vertically integrated cable operators. By facilitating access to this programming, the exclusive contract prohibition has bolstered competition in the MVPD market and benefited consumers. This fundamental benefit must be weighed against any potential costs. Two such costs have been cited by the cable firms in their comments: the prohibition constrains programming diversity and discourages the efficiencies that can arise from vertical integration. A closer examination of these potential costs suggests that they are very unlikely to outweigh the benefits of the prohibition for three reasons.

  - First, since the introduction of the exclusive contract prohibition, programming diversity has increased dramatically. The number of national programming channels has risen 223 percent, from 87 in 1992 to 281 in 2001. Indeed, despite the cable firms' arguments to the contrary, the DBS industry likely contributed to the significant increase in programming diversity. The historical channel capacity advantage of DBS appears to have pressured the cable firms to invest in increased channel capacity, which in turn has provided new opportunities to programmers. In addition, the DBS firms have played an important role in providing a launch platform for a number of independent programmers.

- The second reason that the benefits of the exclusive contract prohibition likely outweigh the potential costs is that most of the large cable firms are already vertically integrated. This suggests that the prohibition has not significantly discouraged vertical integration and also suggests that any internal efficiencies obtained from vertical integration may have already been largely captured.

- Finally, when exclusive arrangements are in the public interest, a mechanism already exists for such arrangements to be approved. Since 1992, six petitions have been sought for a waiver of the exclusive contract provision, and the FCC has granted two of them. This record simultaneously demonstrates that the FCC is willing to grant exemptions when exclusive contracts are in the public interest, and also that such exclusive contracts are generally not in the public interest (especially since the number approved is relatively low despite the fact that the most auspicious cases were the ones presumably filed).

- Some commentators have indicated that cable firms will have no incentive to use exclusive contracts to foreclose competition. Such a perspective, however, is inconsistent with current economic theory. It is also belied by two facts: first, when allowed to do so, cable systems have demonstrated a willingness to engage in foreclosure (e.g., Comcast's SportsNet in Philadelphia); and second, the strength of the cable industry's effort to lift the prohibition raises questions about the motivation for that effort.

- The exclusive contract prohibition currently includes a potential loophole: programming transmitted via terrestrial systems is not covered by the exclusivity clause; rather, such programming is subject to the unfair practices prohibition. From an economic perspective, such a loophole is not justified: the particular mode of transmission does not affect the competitive impact of exclusivity. Foreclosure of competition through use of the terrestrial loophole may loom larger in the future as terrestrial transmission becomes cheaper and more readily available. Indeed, the existence of the loophole itself may displace investment from other more productive uses into terrestrial systems, which could then be used to foreclose competition.

- If the MVPD market becomes more competitive and cable systems wield less market power over independent programmers and rival MVPD providers, the FCC can revisit whether the prohibition continues to be necessary. But given the current competitive structure of the market, the prohibition on exclusive contracts between vertically integrated programming and cable operators continues to be in the public interest.

I. Introduction

The Cable Television Consumer Protection and Competition Act of 1992 ("Cable Act of 1992") generally prohibits exclusive contracts for programming between vertically integrated cable programmers and operators.[1] This provision of the Cable Act of 1992 reflects congressional concern that such exclusive contracts could hamper competition in the multi-channel video programming distribution (MVPD) market, thereby harming consumers.[2] The Cable Act of 1992 sunsets the prohibition on October 5, 2002, unless the Federal Communications Commission (FCC) determines that the "prohibition continues to be necessary to preserve and protect competition and diversity in the distribution of video programming."[3]

Although competition in the MVPD market[4] has improved in the last decade (partly due to the prohibition on exclusive contracts), the market is far from fully competitive. Cable operators continue to possess significant market power and continue

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[1] Section 628(c)(2)(D) states that the FCC "shall prohibit exclusive contracts for satellite cable programming or satellite broadcast programming between a cable operator and a satellite cable programming vendor in which a cable operator has an attributable interest or a satellite broadcast programming vendor in which a cable operator has an attributable interest, unless the Commission determines... that such contract is in the public interest." See 47 U.S.C. § 548(c)(2)(D) and 47 C.F.R. § 76.1002(c)(2).

[2] *Implementation of Sections 12 and 19 of the Cable Television Protection and Competition Act of 1992: Development of Competition and Diversity in Video Programming Distribution and Carriage*, First Report and Order, 8 FCC Rcd 3359, 3366 (1993).

[3] See 47 U.S.C. § 548(c)(5) and 47 C.F.R. § 76.1002(c)(6).

[4] The MVPD market includes the cable industry and Direct Broadcast Satellite (DBS) services. Other available MVPD services include home satellite dishes (HSD), multi-channel multi-point distribution service (MMDS), and private cable or satellite master antenna television (SMATV) systems. See *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Seventh Annual Report, 16 FCC Rcd. 6005, 6008 (2001) ("Seventh Cable Competition Report"), at ¶ 3.

to control a significant proportion of programming, including the majority of the most popular programming networks.[5]

Given the current state of competition in the MVPD market, cable systems still have the incentive and ability to disadvantage rivals and harm competition through exclusive distribution of vertically integrated programming. The prohibition on exclusive contracts should thus be retained and not allowed to sunset in October 2002.

II. Vertical Relationships and Exclusivity Incentives

In many circumstances, vertical relationships and exclusive distribution agreements improve economic efficiency. However, such arrangements can also be exploited in a way that harms competition and consumers.

Economic theorists have developed a variety of models to examine the impact on competition from vertical relationships and exclusivity.[6] One set of models explains the incentives for vertical integration based on efficiency motivations, including the elimination of successive markups by firms with market power.[7] Another relatively

[5] Seventh Cable Competition Report at ¶ 5, App. D, Table D-6, and App. D, Table D-7.

[6] Most economic models assume "upstream" firms that supply an input to "downstream" firms who subsequently sell a good to consumers. In this case, the programmers are the upstream firms and MVPD providers are the downstream firms.

[7] As the FCC has noted, the potential efficiencies in the MVPD marketplace arise "in the production, distribution, and marketing of video programming, and providing incentives to expand channel capacity and create new programming by lowering the risks associated with program production ventures." See Seventh Cable Competition Report at ¶ 172. Efficiency can also arise if there is market power in both the upstream and downstream markets by encouraging the combined firm to take the loss of downstream customers into account when pricing upstream products. It should be noted that this so-called double marginalization problem is also eliminated as either the upstream or downstream markets become competitive. In addition, mergers of successive monopolists in multi-product industries do not necessarily improve welfare by eliminating double marginalization. See Michael A. Salinger, "Vertical Mergers in

recent set of models examines the incentives for firms to establish exclusive vertical relationships to foreclose competition.

An earlier literature had argued that vertically integrated firms could have no anticompetitive incentives to exclude rivals and that rivals could always protect themselves by contracting with other unintegrated firms.[8] However, as Michael Riordan and Steven Salop demonstrate, this "Chicago" view that vertical integration cannot enhance market power is predicated on a number of potentially unrealistic assumptions, including an assumption that the downstream market is perfectly competitive. In the absence of these assumptions, vertical mergers "have the potential for anticompetitive effects by creating, enhancing, or facilitating the exercise of market power."[9] More recent models have developed this post-Chicago view and shown that vertical integration can harm competition and increase prices for consumers.

In a paper published in a leading economics journal, Janusz Ordover, Garth Saloner, and Steven Salop demonstrate that a downstream firm can use exclusive vertical integration with an upstream firm and deny upstream supply to downstream rivals.[10] By eliminating an upstream supplier, the downstream firm can reduce competition in the

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Multi-Product Industries and Edgeworth's Paradox of Taxation," *Journal of Industrial Economics*, September 1991, 39(5), pages 545-56.

[8] Two often cited examples are Robert H. Bork, *The Antitrust Paradox*, (New York: Basic Books, 1978) pages 222-245 and pages 299-309; and Richard A. Posner, *Antitrust Law*, (Chicago: University of Chicago Press, 1976) pages 171-184. Some cable firms have used the logic from these papers to argue that DBS providers could always replace any vertically integrated cable exclusive programming by contracting with independent programmers.

[9] Michael H. Riordan and Steven C. Salop, "Evaluating Vertical Mergers: A Post-Chicago Approach," *Antitrust Law Journal*, Volume 63, 1995, page 519.

[10] See Janusz Ordover, Garth Saloner, and Steven Salop, "Equilibrium Vertical Foreclosure," *American Economic Review*, March 1990, 80(1), pages 127-142.

upstream market, and therefore cause higher prices for unintegrated upstream supply. Assuming that the downstream providers have different characteristics, the authors find that vertical integration benefits the integrating firms – but harms consumers and competition in the downstream market. In addition, the remaining independent downstream firm will not be able to induce the remaining upstream firm to vertically integrate because it will not produce enough profit in the downstream market to compensate the upstream firm for exclusivity. Finally, the benefits of integration accruing to the integrated firm <u>increase</u> if downstream competition becomes more vigorous.[11] As the downstream firms' products become closer substitutes for each other, the benefits to the integrated firm of raising a rival's costs become more significant.[12] An application of this model to the MVPD market would suggest that cable systems (downstream firms) use exclusivity with program providers (upstream firms) in order to foreclose competing MVPD access to integrated programming. As competition between cable systems and other MVPDs intensifies, the anticompetitive effects of exclusive vertical integration become more pronounced.

Oliver Hart and Jean Tirole developed a model in which vertical integration coupled with exclusivity leads to a decline in output and social welfare (as well as a drop in profits and output for the unintegrated downstream firm).[13] In one version of their model, exclusive vertical integration eliminates the integrated downstream firm as a

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[11] Ordover, Saloner, and Salop state that "Our main conclusion is that anticompetitive foreclosure arises as an equilibrium phenomenon in a coherent model where sophisticated firms use a wide range of strategies and counterstrategies." See Ordover, Saloner, and Salop, page 140.

[12] Conversely, if the two downstream firms' products are not particularly close substitutes, raising a rival's costs does not significantly raise the integrated firm's profits (since fewer customers will be induced to switch to the integrated firm).

customer of the unintegrated upstream firm, and the unintegrated upstream firm therefore cannot cover its fixed costs. As a result, the unintegrated upstream firm exits the upstream market, leaving the integrated firm as a monopolist. In another version of the model, the authors assume that upstream capacity is limited. In this version, vertical integration eliminates access to the integrated upstream firm's product and can cause the independent downstream firm to exit. This again allows the integrated firm to monopolize the market. Hart and Tirole conclude:

> "According to our variants, restriction of competition is most likely to be a factor when the merging firms are efficient (have low marginal costs or investment costs) or are large (have high capacities) relative to nonmerging firms...the theory suggests that vertical mergers involving efficient or large firms should be the particular scrutiny by the antitrust authorities...a merger between an upstream and downstream firm that have had substantial dealings with outside firms is potentially more damaging than one between those that have primarily traded with each other and where the foreclosure effect on rivals will be small."[14]

In this type of model, cable systems can limit access by other MVPDs to their integrated programming, reduce competition, and thereby harm consumers. The effectiveness of this foreclosure is strongest against MVPDs that are dependent on vertically integrated cable programming and independent programmers who are dependent on cable carriage.

Vertical integration and exclusive contracts can thus lead to anticompetitive effects that harm consumers and competitors. Christopher Snyder summarizes the models as demonstrating two effects: a commitment effect and an investment effect.

> "The *commitment* effect refers to the ability of a vertically-integrated firm to commit to restrict output to downstream competitors. Commitment comes from profit sharing: because an integrated upstream unit shares the

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[13] Oliver Hart and Jean Tirole, "Vertical Integration and Market Foreclosure," *Brookings Papers: Microeconomics*, 1990, pages 205-286.
[14] Hart and Tirole, page 213.

> profit of its downstream counterpart, it is harmed by increases in the output of rival downstream firms. Therefore, it has an incentive to cut back input supplies to rivals of its downstream counterpart....the *investment* effect is that vertical integration may allow the integrated firm to increase its share of the surplus at the expense of rivals. If the harm to rivals is great enough, they will reduce their investment, possibly exiting the industry, leading to greater concentration."[15]

Whether vertical integration helps or harms consumers depends on whether any pro-consumer efficiencies dominate any anticompetitive effects, which itself depends on the specifics of the market under investigation.[16] A key issue is market power. For example, even Economists Incorporated (EI) notes that "...some factors that make exclusivity more or less likely to harm consumers can be illustrated by example. The key issues are market definition and market power."[17] Economists John Kwoka and Lawrence White similarly concluded, "uses of vertical practices or structure to achieve anticompetitive ends require the actual or potential presence of market power (individually or collectively)."[18] It is therefore essential to examine the specifics of the MVPD market. Before doing so, however, it is necessary to explore several other theoretical considerations.

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[15] Christopher M. Snyder, "Empirical Studies of Vertical Foreclosure," in Bob Hawkins, editor, *1995 Industry Economics Conference Papers and Proceedings* Report 95/23 (Canberra: Australian Government Publishing Service, 1995), pages 98-125 and page 107.

[16] See Michael A. Salinger, "Vertical Mergers and Market Foreclosure," *Quarterly Journal of Economics*, May 1988, 103(2), pages 345-56.

[17] Economists Incorporated, "Competition For Video Programming: Economic Effects of Exclusive Distribution Contracts," December 3, 2001, Filed with the Comments of Cablevision Systems Corp. ("EI Report"), page 10.

[18] John A. Kwoka and Lawrence J. White, editors, *The Antitrust Revolution: Economics, Competition, and Policy* (Oxford: Oxford University Press, 1999), page 331.

Exclusive vertical integration vs. exclusive contracts between independent entities

Some, but by no means all, anticompetitive effects from exclusive relationships require vertical integration, as opposed to exclusive contracts between independent entities. EI claims that if there were anticompetitive benefits to cable systems arising from exclusive relationships that were prevented by law, cable systems could have sold off their programming and then entered into exclusive contracts with the "independent" programmer (since such exclusive contracts are permitted under the Cable Act of 1992).[19] This perspective, however, assumes that exclusive vertical integration is effectively equivalent to exclusive contracts. But EI itself admits that such a perspective is misguided; arms-length contracts may not align a programmer's incentives with the interests of a cable provider since "it is too difficult to write contracts that make the outside supplier's economic incentives compatible with the incentives of the firm."[20]

The difficulty of aligning incentives in a contractual relationship, as opposed to a vertically integrated firm, affects the ability to engage in anticompetitive behavior. In particular, foreclosing competition requires specific profit-sharing schemes between the upstream and downstream firms (which EI implicitly acknowledges in its argument that exclusive vertical integration is equivalent to exclusive contracts).[21] But, as Hart and Tirole emphasize, "Profit sharing may be difficult to implement in the absence of integration, however, because independent units can divert money and misrepresent

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[19] EI states that "Put differently, if cable MSOs had thought that foreclosing of MVPDs would be profitable they need only have spun off their programming interests to independent owners and entered into exclusive contracts with them back in 1992." See EI Report, page 17.
[20] EI Report, page 6.
[21] EI Report, pages 16-17.

profits. In contrast, the owner of a subordinate unit, because he or she has residual rights of control over the unit's assets, may be able to prevent diversion and enforce profit sharing."[22] Furthermore, anticompetitive behavior is less likely with exclusive contracts than with vertically integrated firms because the former is much easier for regulators to monitor.[23] Thus, exclusive contracts are not a perfect substitute for integration.[24]

MVPD programming vs. broadcast programming

The technology and structure of the MVPD market make the incentives and effects of exclusive contracts significantly different than other broadcast markets. Due to the subscription nature of MVPD consumer purchasing, denying some programming to an MVPD can cause subscribers to move from one MVPD provider to another. By contrast, exclusivity for programming on the broadcast networks (e.g., ABC, NBC, and CBS) does not require viewers to adopt the entire bundle of broadcast programming in order to view the exclusive programming.

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[22] Hart and Tirole, page 206.

[23] Arms-length transactions between independent firms are easier to police for anticompetitive effects. EI argues that a *per se* rule prohibiting exclusive contracts with integrated firms is not required when other policing actions are available: "Case-by-case antitrust remedies are far more appropriate in dealing with such issues than a blanket *per se* rule affecting all cable operators. Antitrust remedies include not only prosecutions by the Department of Justice and the Federal Trade Commission but also actions by State Attorneys General and private treble damage actions." See EI Report, page 23. EI's argument does not take into account the differential costs of monitoring and enforcing competition in an exclusive integrated setting relative to an exclusive contractual one. One way of interpreting the current prohibition is that it targets the relationships that are most difficult to police with conventional antitrust tools. In addition, as two former FCC attorneys stated in the context of the MVPD market, a regulatory approach is "less costly, far faster, and more effective than if prospective plantiffs sought similar relief under the antitrust laws. By adjudicating these claims before a single, expert agency [the FCC] – as opposed to through cases arising in a variety of jurisdictions – it is possible to achieve a consistent program access policy, and thus improve overall market performance. Moreover, because responsible telecommunications policy must be able to quickly and adequately respond to industry structure, conduct, and performance, an administrative agency with industry expertise is better equipped to analyze and react to such changes than would be a series of courts." See James Olson and Lawrence Spiwak, "Can Short-Term Limits on Strategic Vertical Restraints Improve Long-Term Cable Industry Performance?" *Cardozo Arts & Entertainment Law Journal*, 283 (1995) (footnotes omitted).

For example, if NBC has an exclusive right to broadcast the Olympic Games, a viewer would have to watch NBC to see the events. But the viewer does not have to switch to NBC to watch all other "over-the-air" programming. By contrast, if NBC were carried on cable systems and not on DBS systems, the viewer would have to switch all programming from DBS to cable (or incur the added cost of subscribing to both DBS and cable) in order to view the Olympics.[25]

The example of Fox's entry into network programming, cited by EI as support for the view that a prohibition on exclusive contracts is unnecessary, illustrates the crucial difference between the broadcast market and the MVPD market.[26] To watch the new Fox programming, viewers were not required to forgo all programming available on other networks. Since most consumers currently subscribe to one MVPD, on the other hand, an entrant in the MVPD market would have to offer consumers an entire lineup of programming that would be more attractive than their existing programming choices. Fox only had to offer a few individual popular programs, but an MVPD must enter by offering an entire portfolio of attractive programming. Thus, if programming that is necessary to attract new subscribers is not available to all MVPD providers, an entrant is unlikely to be successful.

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[24] Hart and Tirole, pages 208-209.

[25] This example is meant to be illustrative. NBC broadcasts are also available over the air to DBS or cable consumers, so in this case the viewer would not necessarily be forced to switch MVPD providers – instead, she could view the Olympics over the air (assuming that she had the ability to receive over-the-air signals). A more precise example would involve programming that is available exclusively on MVPD systems.

[26] EI states that "It is noteworthy that it did not occur to the Commission to facilitate Fox's entry by requiring ABC, CBS and NBC to share with the new entrant all those networks' own program production." See EI Report, page 25.

III. The State of Competition in the MVPD Market

Although competition in the MVPD market has improved since the early 1990s, the FCC recently stated that cable television "still is the dominant technology for the delivery of video programming to consumers in the MVPD marketplace."[27] In particular, despite DBS subscriber growth, cable firms provided service for more than 77 percent of all MVPD subscribers in July 2001.[28]

Reflecting their growing market share, DBS firms have started to exert some pressure on cable pricing and innovation. For example, the FCC found that 2000 was the first year in which DBS providers influenced prices for cable service in a statistically significant manner.[29] Nonetheless, the effect is modest, presumably reflecting the continued dominant position of the cable firms.

Furthermore, the market power of cable firms may well increase in the future. One reason that the DBS firms have succeeded in exerting even modest pressure on cable prices is that they offer more channels, better sound, and higher picture quality than analog cable. This competitive advantage, however, is fading as cable firms introduce digital cable systems, which reduces or eliminates the historical quality and capacity advantages of DBS over analog cable and offers the possibility of bundling high-speed

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[27] Seventh Cable Competition Report at ¶ 5.

[28] See Comments of National Cable & Telecommunications Association, In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, Notice of Inquiry, CS Docket No. 01-129, (dated August 2, 2001), at ¶ 7.

[29] *Statistical Report on Average Rates for Basic Service, Cable Programming Services, and Equipment,* Report on Cable Industry Prices, FCC (2001), at ¶ 53.

Internet access, video-on-demand, and other advanced services – all of which the DBS firms currently have difficulty matching. For example, Goldman Sachs recently concluded that "We see the bundling of [cable] services as the most significant threat to DBS because of its potential not only to slow gross additions, but also to win back subscribers (seen through higher churn)."[30]

According to the National Cable and Telecommunications Association (NCTA), the number of digital cable subscribers has increased nine-fold in the past three years, rising from 1.5 million in 1998 to 13.7 million in November 2001.[31] Moreover, consumers who commit to a digital cable/cable-modem bundle may perceive fewer benefits to moving to DBS (relative to analog cable customers).[32] Therefore, at any given market share for cable providers, digital cable systems may strengthen the market power enjoyed by cable firms.

One of the premises of the exclusive contract prohibition was that cable firms had significant power in the MVPD market. Despite claims that the structure of the MVPD market has changed enough to make foreclosure unprofitable,[33] cable firms are still dominant in the market and the fundamental motivation for the prohibition therefore has

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[30] See Goldman Sachs, "Satellite Communications: DBS Operators," December 18, 2000, page 1.

[31] For data on the growth of digital cable see the NCTA website at http://www.ncta.com/industry_overview/indStats.cfm?statID=14.

[32] Goldman Sachs similarly notes that "As cable operators upgrade their networks and roll out new service, cable subscribers will have less incentive to 'churn' to DBS." See Goldman Sachs, "Satellite Communications: DBS Operators," December 18, 2000, page 33.

[33] For example, EI states that "the same changes that have made foreclosure much more expensive today than in the past have made it less profitable." See EI Report, page 11.

not significantly changed.[34] In other words, cable firms continue to have enough market power to have incentives to foreclose access to programming and harm competition and consumers.

Regardless of the concentration in the MVPD market, cable firms claim that the entry of new independent programming has significantly weakened their ability to effectively foreclose access to enough programming to have anticompetitive effects.[35] Indeed, the cable industry argues that over the past decade the percentage of vertically integrated programming services has declined from roughly half in 1992 to 26 percent in 2001.[36] But these figures are not weighted by subscribership or viewer ratings, which are the more appropriate methods of analysis. The fact remains that much of the most popular programming continues to be vertically integrated. For example, according to the FCC, four of the top six for-profit video programming networks ranked by subscribership are vertically integrated with a cable provider.[37] In addition, three out of the top five video programming networks ranked by prime-time ratings are vertically

[34] A model developed by economist Michael Riordan demonstrates that vertical integration by a dominant downstream firm into an upstream competitive market can be anticompetitive. Riordan explains that the anticompetitive effect arises because the dominant firm raises the price of the upstream input, reduces the size of the other fringe competitors in the downstream market, and thereby gains more power in the downstream market. See Michael H. Riordan, "Anticompetitive Vertical Integration by a Dominant Firm," *American Economic Review*, Vol. 88, No. 5, December 1998, pages 1232-1248.

[35] See Comments of AOL Time Warner, Inc., In the Matter of Implementation of the Cable Television Consumer Protection and Competition Act of 1992, Development of Competition and Diversity in Video Programming Distribution: Section 628(c)(5) of the Communications Act: Sunset of Exclusive Contract Prohibition, CS Docket No. 01-290, (dated December 3, 2001), ("AOL Time Warner Comments") at 18; Comments of AT&T, Inc., ("AT&T Comments") at 19-22; Comments of Cablevision Systems Corporation, ("Cablevision Comments") at 30-31; Comments of Comcast Corporation, ("Comcast Comments") at 7-8; and Comments of National Cable & Telecommunications Association, ("NCTA Comments") at 11-13.

[36] See NCTA Comments at 11-12.

[37] See Seventh Cable Competition Report, App. D, Table D-6. C-SPAN has the fifth highest number of subscribers among all programming networks, but it is not a for-profit entity. In addition, AT&T Broadband recently spun-off its stake in USA Networks, which was ranked third in the Seventh Cable Competition Report.

integrated with cable firms.[38] These top channels (e.g., TBS, USA, TNT) are critically important to DBS firms in offering a viable alternative to cable providers.[39] The lack of close substitutes for these top channels facilitates the effectiveness of anticompetitive foreclosure.[40]

Furthermore, horizontal consolidation in the cable industry increases the incentives for anticompetitive foreclosure of access to integrated programming. The intuition is simply that the costs of foreclosure are the forgone revenue from all other MVPD outlets. In particular, an integrated cable firm that denies access to its programming to a DBS firm forgoes the revenue that the DBS firm would have paid for the programming. Since the DBS firms operate on a national basis, the forgone revenue effectively covers the entire *national* subscriber base of the DBS firms. The benefit of foreclosure is that it increases relative demand for the cable package (because that package is the only avenue to view the exclusive programming). In addition to the

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[38] See Seventh Cable Competition Report, App. D, Table D-7. Prime-time ratings are one measure of a network's value to subscribers. But, as noted in the text below, there is also significant value to consumers of offering a wide variety of channel choices. Ratings do not indicate the strength of a consumer's preference for a specific channel (but rather just that that channel was preferred to others). It is entirely possible that the consumer surplus associated with a network with a smaller, but extremely devoted, group of viewers may be larger than that of a network with a larger subscriber base.

[39] Economists David Waterman and Andrew Weiss stated that there was an industry consensus that "the lack of more than one or two of the well-known networks such as ESPN, USA, CNN, and HBO would seriously handicap a multichannel competitor to an established cable system." Quoted in James Olson and Lawrence Spiwak, "Can Short-Term Limits on Strategic Vertical Restraints Improve Long-Term Cable Industry Performance?" *Cardozo Arts & Entertainment Law Journal*, 283 (1995). In addition, many smaller, "niche" networks also remain affiliated with cable operators. Even if each of these networks is less crucial on a stand-alone basis than each of the top-rated networks, consumers value "more channels" and thus, these smaller channels in their totality may represent an important component of an MVPD providers' programming offering.

[40] Even EI recognizes the importance of substitutability in determining the potential anticompetitive effects of foreclosure. "It does no good for a cable operator to deny a program to a rival MVPD if the rival MVPD can readily obtain substitute programming elsewhere, through purchase or through its own vertical integration." See EI Report, page 20. In addition, EI points out that successful foreclosure would require that a significant number of cable programs be foreclosed or "alternatively the integrated firm might

potential increase in the cable system's prices, the gains from foreclosure are reflected by the number of subscribers that shift from alternatives to the vertically integrated cable system in order to view the foreclosed programming (or that remain with the cable system when they would have otherwise moved). A cable system with wider geographic coverage will gain a larger portion of the shifting subscribers (or retain a larger share of subscribers who would have otherwise switched MVPD services). In other words, the larger the size of the integrated cable firm's potential subscriber base, the larger the potential benefit from foreclosing access to programming.

The trend toward horizontal consolidation in the cable industry thus increases the returns from anticompetitive foreclosure, without increasing the costs thereof.[41] In the spring of 1995, the top ten cable systems accounted for less than 60 percent of cable subscribers nationwide.[42] Currently, the ten largest cable operators serve close to 90 percent of all U.S. cable subscribers.[43] If consummated, the recently announced purchase of AT&T Broadband by Comcast will further increase cable and program ownership concentration.[44] And this trend toward horizontal consolidation may continue; Ted

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attempt to harm competitors by denying access to the most valuable programming." See EI Report, page 20.

[41] Increased horizontal consolidation can also have other anticompetitive effects that do not directly involve exclusive vertical integration and, therefore, are not examined here.

[42] See Deborah Solomon and Robert Frank, "Comcast-AT&T Broadband Deal Cements Rise of Cable Oligopoly," *Wall Street Journal*, December 21, 2001, and data from the National Cable and Television Association web site, available at http://www.ncta.com/industry_overview/indStats.cfm?statID=1.

[43] Seventh Cable Competition Report at ¶ 15.

[44] Christopher Stern, "Giant Cable Merger Planned, AT&T, Comcast Set $72 Billion Deal," *The Washington Post*, December 20, 2001. The merged entity – AT&T Comcast – would have roughly 22 million subscribers. But such a figure does not include the MVPD subscribers served by entities in which AT&T Broadband currently has an attributable interest; for example, AT&T Broadband has a 25 percent stake in Time Warner's cable systems. According to AT&T Broadband, "If [Time Warner Entertainment] and [Time Warner, Inc.] subscribers were nonetheless added to AT&T's totals, AT&T would be attributed with approximately 32,926,000 subscribers." See Letter from Douglas Garrett to Magalie Roman Salas, *Ex Parte* Submission, MM Docket No. 92-264, CS Docket No. 99-251, December 18, 2001, at 2. If

Turner recently predicted that cable consolidation will "result in only two operators still standing within a year or two."[45]

IV. The Costs and Benefits of Maintaining the Exclusive Contract Prohibition

Executives at both EchoStar and DIRECTV confirm that without access to the programming available on cable systems (which could have been denied in the absence of the prohibition), the DBS firms would not have experienced dramatic subscriber growth.[46] Similarly, the FCC has noted that "the program access rules have been credited as having been a necessary factor" in the development of the DBS industry.[47] Despite the growth of DBS providers, cable firms continue to maintain significant pricing power in the MVPD market and it is therefore premature to sunset the exclusive contract prohibition – especially given the trend toward horizontal consolidation in the cable industry and the introduction of digital cable.

The cable industry argues that the exclusive contract prohibition is no longer needed because the MVPD market is fully competitive and thus foreclosure would not be a profitable strategy. The available evidence, however, suggests that the MVPD market

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attributable subscribers are thus included, the combined AT&T Comcast would have more than 40 million subscribers – nearly 33 million AT&T subscribers and roughly 8 million Comcast subscribers – representing roughly half of all MVPD subscribers.

[45] Sallie Hofmeister, "Ted Turner Says Only 2 Cable Firms May Survive," *Los Angeles Times*, November 29, 2001.

[46] For example, in 1995, DIRECTV's marketing head stated that "without [program access], we would have been dead." See Eric Schine, "Digital TV: Advantage, Hughes," *Business Week*, March 13, 1995, at 66-67.

[47] See *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Fourth Annual Report, CS Docket No. 97-141 (1998) at ¶ 230.

is not fully competitive (see above) and that cable firms may indeed use exclusive arrangements to consolidate further their market power.

One telling example of the potential dangers associated with allowing programming exclusivity in the context of vertically integrated cable systems is the experience of Comcast's SportsNet, a channel devoted to Philadelphia sports programming.[48] Survey evidence suggests that regional sports programming is critical to competition in the MVPD market. According to one recent survey, between 40 and 58 percent of cable subscribers would be less likely to subscribe to an MVPD provider if it lacked local sports.[49]

The key to the SportsNet story is a potential "loophole" in the existing exclusivity rules: programming distributed via terrestrial systems (as opposed to satellite-based delivery) is not subject to the exclusivity clause, but only to the unfair practices prohibition.[50] Since Comcast is able to distribute programming in Philadelphia entirely through terrestrial systems, it has been allowed to refuse to provide SportsNet to competing MVPDs – and has chosen to do so. As Comcast itself has stated, SportsNet "provides a significant marketing advantage against satellite and other competitors."[51]

[48] SportsNet is a partnership between the Philadelphia Phillies and Comcast-Spectator, a division of Comcast that also owns the Philadelphia Flyers, Philadelphia 76ers, the First Union Center, and the Spectrum. See Patricia Horn, "Comcast has an Edge in Popular SportsNet," *The Philadelphia Inquirer*, October 29, 2000, ("Horn") page E01.

[49] See Comments of RCN Telecom Service, Inc., at 18.

[50] The Cable Act of 1992 prohibits "exclusive contracts for satellite cable programming or satellite broadcast programming." See 47 U.S.C. § 548(c)(2)(D) and 47 C.F.R. § 76.1002(c)(2). The FCC has interpreted this provision to mean that programming transmitted via terrestrial systems is allowed under the Cable Act of 1992. See Federal Communications Commission, *1998 Program Access Order*, CS Docket No. 97-248, (released August 6, 1998).

[51] Seventh Cable Competition Report at ¶ 186.

As noted above, if cable firms are able to induce subscribers to commit to a digital cable/cable-modem bundle today, it may be more difficult for the DBS firms to induce the subscribers to switch to DBS in the future.[52] Therefore, if cable firms use exclusive arrangements to "lock in" customers, such arrangements can have a long-term deleterious effect on competition.[53]

Comcast's arrangement with SportsNet illustrates how cable firms can use exclusivity to gain market share, which helps to lock in subscribers and potentially harm competition in the future.[54] While many factors can influence the DBS penetration rate in a particular market, the lack of regional sports programming appears to have reduced DBS subscribership in Philadelphia. For example, Table 1 presents data from Forrester Research showing that the DBS penetration rate in Philadelphia is by far the lowest of the top 20 cities in the United States. Indeed, the DBS penetration rate in Philadelphia is just 3.9 percent, or less than half the 9.3 percent weighted average for the top 20 cities (other

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[52] See Robert D. Willig, Declaration On Behalf Of Echostar Communications Corporation, General Motors Corporation, and Hughes Electronics Corporation, *Echostar Communications Corporation, General Motors Corporation, and Hughes Electronics Corporation Seek FCC Consent For A Proposed Transfer Of Control*, CS Docket No. 01-348, (released December 21, 2001), ("Willig Declaration") at ¶ 34.

[53] If a cable firm is able to lock in subscribers, the firm increases its power to raise prices. Such pricing power can thus be used to adversely affect customers in the future.

[54] One local Philadelphia broadcast station recently contended that "Comcast uses its local sports programming to hamper competition by refusing to make SportsNet available to satellite-TV providers. SportsNet 'is a key part of their strategy to monopolize this market,' said Dave Davis, WPVI president and general manager." See Horn, page E01.

than Philadelphia).[55] DBS penetration rate data supplied to us by both EchoStar and DIRECTV are generally consistent with this finding.[56]

The Philadelphia example may be indicative of what could occur in the absence of the prohibition on exclusive contracts. Indeed, the cable operators are strongly advocating that they be permitted to enter into exclusive arrangements with their integrated programmers.[57] Yet, they have demonstrated little demand for exclusive arrangements with independent programmers. This combination of factors is not necessarily determinative of the cable firms' motivation for exclusivity, but it is at least suggestive that they are eager to use exclusive arrangements with their integrated programmers for anticompetitive purposes. That is, if the efficiency improvements from exclusivity were overwhelming, one would suspect that the cable firms would have sought to enter into such agreements with independent programmers (which are generally allowed under the Communications Act), despite the differences between such exclusive contracts and exclusive vertical integration noted above.[58]

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[55] The *Philadelphia Inquirer* reported in June 2001 that, according to Nielsen Media Research, of the 2.7 million homes with televisions in the Philadelphia region, only 3.7 percent subscribed to DIRECTV or EchoStar, compared to more than 10 percent of TV households nationwide. See Patricia Horn, "As Competition Lags for Cable TV, Prices Tend to Rise," *Philadelphia Inquirer*, June 3, 2001, page C01.

[56] As a DIRECTV spokesman was quoted describing Philadelphia, "We clearly don't have the same kind of success in getting customers in that area as we have in other similar markets, due to this issue with Comcast. These SportsNets are like local channels. They are part of a local package that is essential for us to be fully competitive with cable." See Horn, page E01.

[57] See, for example, Cablevision Comments at 15-18 and Comcast Comments at 9-11.

[58] The absence of significant efficiencies from exclusive arrangements in the MVPD market is also suggested by the relative paucity of exclusive contracts between DBS firms and independent programmers (which are also allowed under current law). For an independent programmer to be willing to enter into an exclusive contract with a MVPD firm, the MVPD firm must be willing to compensate the programmer for forgoing the revenue from all other MVPD outlets in the region covered by the contract (and there must be a creditable profit-sharing system, as noted above). Since cable firms account for nearly 80 percent of the MVPD market, it is unlikely that a non-cable MVPD provider would find it profitable to engage in such an exclusive arrangement. Indeed, even though EchoStar and DIRECTV are both allowed under FCC regulations to have exclusive contracts with programmers, DIRECTV has not signed an exclusive contract that bars non-DBS providers from access to programming. As noted by the FCC, DIRECTV has an

Table 1 Direct Broadcast Satellite Subscriber Penetration: January 2001	
City	**DBS Penetration Rate**
Dallas	20.2%
Houston	17.7%
Denver	14.1%
St. Louis	13.6%
Atlanta	12.4%
Phoenix	11.8%
Portland	11.2%
Minneapolis - St. Paul	10.4%
Los Angeles	10.2%
Washington	10.1%
Detroit	10.0%
Seattle	8.9%
Cleveland	7.9%
Chicago	7.7%
Pittsburgh	7.3%
San Diego	7.3%
New York	5.3%
Boston	4.9%
San Francisco	4.8%
Philadelphia	3.9%

Source: Forrester Research, Inc., Technographics Benchmark Survey, 2001

Maintaining the prohibition on exclusive contracts for video programming among vertically integrated cable firms attenuates the potential for anticompetitive behavior. This benefit must be weighed against any potential costs imposed by the prohibition. Cable firms argue that the prohibition constrains programming diversity and discourages

"exclusive arrangement with the National Football League (NFL) to make available to subscribers a substantial package of NFL games each Sunday." See Federal Communications Commission, *In The Matter of Implementation of the Cable Television Consumer Protection Act of 1992*, FCC 01-307 (released October 18, 2001) at ¶ 10. But the agreement between DIRECTV and the NFL is not truly exclusive, since it does not apply to agreements between the NFL and cable companies or other non-DBS MVPD providers (e.g., C-band satellite distributors). See Comments of DIRECTV, Inc., ("DIRECTV Comments") at 7. To the extent that EchoStar's subsidiary Kelly Broadcasting Systems, Inc. ("Kelly") has obtained exclusive distribution rights for certain foreign language networks (e.g., Greek, Russian, Arabic), it did so through arm's length negotiations with foreign programmers, not through acquisition of control over these programmers. Furthermore, those rights mean only that other U.S. distributors must deal with Kelly (as opposed to the foreign content providers) with respect to this programming.

the efficiencies that can arise from vertical integration.[59] A closer examination of these potential costs, however, suggests that they are very unlikely to outweigh the benefits of the prohibition for three reasons.

First, it is important to recognize that programming diversity has increased dramatically since the introduction of the prohibition on exclusive contracts. Since 1992, the number of national programming channels has increased 223 percent, from 87 in 1992 to 281 in 2001.[60] Despite the cable firms' arguments to the contrary, the DBS industry likely contributed to the significant increase in programming diversity.

A number of commentators argued that the DBS industry obtained a "free ride" through the exclusive contract prohibition, which in turn has reduced the incentives of both vertically integrated cable operators and DBS firms to create new programming.[61] But this perspective ignores the dynamic impact the exclusive contract prohibition has had on bolstering competition and programming diversity in the MVPD market. In particular, DBS has historically held an advantage relative to analog cable in terms of channel capacity, and consumers have indicated a strong preference for such capacity. For example, a recent survey of new DBS subscribers found that the leading reason for switching to DBS was "more channels."[62] That revealed preference, in turn, has

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[59] See AT&T Comments at 7-8; Cablevision Comments at 8-9; Comcast Comments at 13, and NCTA Comments at 16-17.
[60] NCTA Comments at 12.
[61] See AT&T Comments at 8 & 12; Cablevision Comments at 9 & 16; and NCTA Comments at 16.
[62] According to a survey by The Yankee Group, the top five reasons for people switching to DBS were more channels (79 percent), greater movie selection (69 percent), clearer picture and sound (66 percent), dissatisfied with cable (46 percent), and cable was too expensive (44 percent). See Satellite Broadcasting & Communications Association Press Release, "Study Shows Satellite TV Increasing Urban Penetration," August 14, 2000.

pressured the cable firms to invest in increased channel capacity. As NCTA President and CEO Robert Sachs stated, "Being digital from the start, and having the advantage of substantially greater channel capacity, DBS spurred cable operators to replace hundreds of thousands of miles of coaxial cable with fiber optics so that they too could offer consumers hundreds of channels of digital video and audio services."[63] The channel capacity advantage of DBS thus appears to have pressured the cable firms to invest in increased channel capacity, which in turn has provided new opportunities to programmers.

In addition, the DBS firms have played an important role in providing a launch platform for independent programmers;[64] as the NCTA stated in its comments, "The allure of DBS coverage for new networks, vertically or non-vertically integrated, is also strong. Unlike the variety of channel positions and system configurations involved in cable system launching, a deal with a DBS provider means immediate nation-wide reach to millions of homes in the same channel."[65] EchoStar's recent announcement of an agreement with Vivendi Universal illustrates how an MVPD provider can facilitate the entry of new programming on a non-exclusive basis.[66] As part of the agreement, Vivendi Universal will develop five new programming channels and EchoStar has agreed to carry

[63] See Robert Sachs, Testimony Before Subcommittee on Antitrust, Business Rights, and Competition, Committee on the Judiciary, United States Senate, April 4, 2001, pages 2-3.
[64] As DIRECTV notes in its comments, "more than a dozen programming channels have been launched on DIRECTV... and more are on the way." See DIRECTV Comments at 6. EchoStar programming executives add that programmers use DBS carriage to improve their bargaining position with cable systems. The programmers assume that DBS carriage will improve their chances, and price, for carriage on cable systems, not that DBS carriage alone will make the new programming profitable.
[65] NCTA Comments at 15.
[66] See EchoStar Press Release, "EchoStar, Vivendi Universal Form Strategic Alliance to Offer New Programming, Interactive Television Services for Consumers," December 14, 2001.

them.[67] While EchoStar and Vivendi Universal could legally enter into an exclusive contract, it is important to note that the new programming under the agreement will be distributed on a non-exclusive basis: that is, the programming will be available to all other MVPD providers. Indeed, incentives are built into the agreement to encourage Vivendi Universal to distribute the new programming to other MVPD providers.

Looking to the future, the proposed merger between EchoStar and DIRECTV will allow the new EchoStar to play an even more important role in expanding programming diversity through increased channel capacity. The proposed merger of EchoStar and DIRECTV could eventually "free up" roughly half the current spectrum used by the individual firms, thus allowing the new EchoStar to increase the number (and diversity) of channels offered to subscribers.[68] Given the preference of MVPD subscribers for "more channels," such an expansion of channel capacity will likely force cable systems to continue to upgrade their program offerings. With more channel capacity on both DBS and cable, programming diversity will likely expand.

While the evidence appears to suggest that the DBS firms contributed to increased programming diversity, a body of empirical literature suggests that vertically integrated cable systems have favored their own programming and excluded similar non-integrated programming. As the FCC noted, cable providers "with large programming interests may

[67] EchoStar and Vivendi Universal will also "work together on a new programming initiative to develop new satellite-delivered broadband channels featuring interactive games, movies, sports, education, and music to be launched within a 3-year period following the consummation of the agreement." See EchoStar Press Release, "EchoStar, Vivendi Universal Form Strategic Alliance to Offer New Programming, Interactive Television Services for Consumers," December 14, 2001.

[68] See Willig Declaration at ¶ 21.

unfairly favor affiliated programming over unaffiliated programming."[69] One recent empirical study of cable system program choices showed that vertically integrated cable systems exclude rival services.[70] The author noted that "TCI [now AT&T Broadband] and Comcast, two operators who own the basic shopping service QVC, are less likely to carry rival shopping service Home Shopping Network (HSN), and they are less likely to carry both QVC and HSN."[71] More broadly, the author concluded that "vertical integration between cable operators and premium program services results in the exclusion of rival services."[72] Previous studies have reached similar conclusions. For example, David Waterman and Andrew Weiss conclude, "The weight of evidence thus supports the conclusion that majority ownership relationships do influence cable systems to 'favor' their affiliated pay networks, both with respect to carriage decisions and overall marketing behavior."[73]

The second reason that the benefits of the exclusive contract prohibition likely outweigh the potential costs is that most of the large cable firms are already vertically integrated. This suggests that the prohibition has not significantly discouraged vertical

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[69] Federal Communications Commission, *In the Matter of Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992, Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996, The Commission's Cable Horizontal and Vertical Ownership Limits and Attribution Rules,* Further Notice of Proposed Rulemaking, CS Docket No. 01-263, (released September 21, 2001), at ¶ 29.

[70] Tasneem Chipty, "Vertical Integration, Market Foreclosure, and Consumer Welfare in the Cable Television Industry," *American Economic Review*, June 2001, 91(3), pages 428-453. It is important to note that the author also finds that there may be offsetting efficiency benefits from vertical integration, because, for example, "integrated operators are better at promoting their products than are unintegrated operators." See Chipty, page 450. The article's arguments and results with regard to efficiency benefits, however, apply to vertical integration – and not directly to the presence or absence of exclusivity in that vertical relationship.

[71] Ibid, page 429. AT&T Broadband no longer has a stake in QVC, but Comcast owns 57 percent of the network.

[72] Ibid, page 450.

integration and also suggests that internal efficiencies obtained from vertical integration may have already been largely captured. Indeed, if the merger between AT&T Broadband and Comcast is consummated, three of the top four cable firms – accounting for roughly half of all cable subscribers – will be vertically integrated.[74] The extent of vertical integration in the cable industry today limits the degree to which eliminating the prohibition would produce internal efficiencies through further vertical integration, while exacerbating the anticompetitive dangers. Furthermore, the prohibition on exclusivity among vertically integrated cable firms is not inherently a disincentive to efficiency-improving vertical integration.[75]

Finally, when exclusive arrangements are in the public interest, a mechanism already exists for such arrangements to be approved. The FCC has the authority to waive the prohibition on the basis of five factors, including the effect of the exclusive contract on competition and the effect of the exclusive contract on programming diversity. Since 1992, six petitions have been sought for a waiver of the exclusive contract provision, and the FCC has granted two of them.[76] This record simultaneously demonstrates that the FCC is willing to grant exemptions when exclusive contracts are in the public interest, and also that such exclusive contracts are generally not in the public interest (especially

[73] David Waterman, and Andrew Weiss, "The Effects of Vertical Integration Between Cable Television Systems and Pay Cable Networks," *Journal of Econometrics*, May/June 1996, 72(1996), page 391.
[74] See Seventh Cable Competition Report at ¶ App. C, Table C-3,.
[75] Economists William Baumol, Janusz Ordover, and Robert Willig have shown that the efficient outcome could be produced by a prohibition on exclusivity combined with an appropriate pricing standard. See William J. Baumol, Janusz A. Ordover, and Robert D. Willig, "Parity Pricing and Its Critics: A Necessary Condition for Efficiency in the Provision of Bottleneck Services to Competitors," *Yale Journal of Regulation*, Vol. 14, No. 1, Winter 1997, pages 145-164.

since the number approved is relatively low despite the fact that the most auspicious cases were the ones presumably filed).

V. Economic Rationale for Terrestrial Loophole

As noted above, the exclusive contract prohibition currently includes a potential loophole: programming transmitted via terrestrial systems is not covered by the exclusivity clause; such programming is subject to the unfair practices prohibition. From an economic perspective, such a loophole is not justified. The particular mode of transmission used to deliver programming does not affect the underlying competitive impact of exclusive contracts between vertically integrated programmers and cable operators. Viewers make no distinction between video delivery methods to MVPDs; the competitive effects of foreclosure are the same whether the signal is delivered by satellite or fiber cable to the cable system facilities. The example of SportsNet in Philadelphia shows that this terrestrial loophole has been used by a cable operator to foreclose competitors' access to essential programming, which has reduced competitive pressures in the local market. Foreclosure of competition through use of the terrestrial loophole may loom larger in the future as terrestrial transmission becomes cheaper and more readily available. Indeed, the existence of the loophole itself may displace investment from other more productive uses into terrestrial systems, which could then be used to foreclose competition.

[76] See, for example, Federal Communications Commission, In the Matter of Time Warner Cable, 9 FCC Rcd 3221 (1994); In the Matter of New England Cable News, 9 FCC Rcd 3231 (1994); In the Matter of Newschannel, 10 FCC Rcd 691 (1994); In the Matter of Cablevision Industries Corp., 10 FCC Rcd 9786 (1995); and In the Matter of: Outdoor Life Network and Speedvision Network, 13 FCC Rcd 12,226 (1998).

VI. Conclusion

Economic theory suggests that vertical integration and exclusive contracts can be used to increase efficiency, but can also be used for anticompetitive purposes. A key determinant of whether vertical integration and exclusive contracts can be used for foreclosure is the level of market power: anticompetitive exclusivity is possible in markets that are not fully competitive.

Cable systems continue to hold an overwhelming share of MVPD subscribers. Thus, in the absence of the prohibition on exclusive contracts, cable operators would still have the incentive and ability to harm consumers by foreclosing access to vertically integrated programming to competing MVPD providers. By not allowing rivals to provide a broad range of programming, integrated cable systems will be able to raise prices to consumers and slow the growth of competitors. Some commentators have indicated that cable firms will not use exclusive contracts to foreclose competition. Such a perspective, however, is belied by two facts: first, when allowed to do so, cable systems have demonstrated a willingness to engage in foreclosure; and second, the strength of the cable industry's effort to lift the prohibition raises questions about the motivation for that effort.

If the MVPD market becomes more competitive and cable systems wield less market power over independent programmers and rival MVPD providers, the FCC can revisit whether the prohibition continues to be necessary. But given the current competitive structure of the market, the prohibition on exclusive contracts between vertically integrated programming and cable operators continues to be in the public interest.

VERIFICATION

I, Jonathan M. Orszag, declare under penalty of perjury that the foregoing declaration is true and correct. Executed on January 4, 2002.

Jonathan M. Orszag

I, Peter R. Orszag, declare under penalty of perjury that the foregoing declaration is true and correct. Executed on January 5, 2002.

Peter R. Orszag

I, John M. Gale, declare under penalty of perjury that the foregoing declaration is true and correct. Executed on January 7, 2002.

John M. Gale

Appendix 1:
Curriculum Vitae of the Authors

December 2001

CURRICULUM VITAE

Jonathan M. Orszag

Jonathan Orszag is the Managing Director of Sebago Associates, Inc., an economic consulting firm, and is based in Los Angeles, CA. He is also an adjunct lecturer at the University of Southern California School of Policy, Planning, and Development. Prior to joining Sebago Associates, Mr. Orszag served as the Assistant to the U.S. Secretary of Commerce and Director of the Office of Policy and Strategic Planning. Previously, Mr. Orszag served as an Economic Policy Advisor on President Clinton's National Economic Council (NEC). For his work on Individual Development Accounts, the Corporation for Enterprise Development awarded Mr. Orszag its 1999 leadership award for "forging innovative public policies to expand economic opportunity in America." Mr. Orszag received his A.B. *summa cum laude* in economics from Princeton University and an M.Sc. from Oxford University, which he attended as a Marshall Scholar.

PROFESSIONAL EXPERIENCE:

- **Managing Director**, Sebago Associates, Inc. (Marina del Rey, CA), March 2000-Present. Manage economic and public policy consulting firm. Provide analytical support and advice to public- and private-sector entities in the United States and in foreign countries (such as Argentina, Ecuador, The Bahamas, and Trinidad & Tobago).

- **Lecturer**, University of Southern California (Los Angeles, CA), January 2002-. Taught course on the making of economic policy in the executive branch.

- **Assistant to the Secretary and Director of the Office of Policy and Strategic Planning,** U.S. Department of Commerce (Washington, D.C.), March 1999-March 2000. Served as the Secretary of Commerce's chief policy adviser. Responsible for coordinating the development and implementation of policy initiatives within the Department. Worked on a wide range of issues, from implementing the steel loan guarantee program to telecommunications and e-commerce issues. Represented the Secretary of Commerce in meetings with other government officials and outside organizations, and testified before Congress on behalf of the Department on budget and Native American economic development issues.

- **Economic Policy Advisor**, National Economic Council, The White House (Washington, D.C.), August 1997-March 1999; Assistant Director, January 1996-November 1996. Responsible for helping to coordinate the Administration's daily economic message and to promote (and defend) President Clinton's economic record. Coordinated policy processes on a wide range of issues, from Social Security reform to job training reform, unemployment insurance reform, homeownership and low-income housing issues, the minimum wage, and Individual Development Accounts.

- **Economics Teacher,** Phillips Exeter Academy Summer School (Exeter, New Hampshire), June 1997-August 1997. Taught introductory macroeconomics at Phillips Exeter Academy Summer School.

- **Economic Consultant,** James Carville (Washington, D.C.), August 1995-January 1996. Helped James Carville, President Clinton's 1992 campaign strategist, research and write his *New York Times* #1 best-selling book, *We're Right, They're Wrong: A Handbook for Spirited Progressives.*

- **Special Assistant to the Chief Economist**, U.S. Department of Labor, (Washington, D.C.), August 1994-August 1995. Served as an economic aide to the Chief Economist (Alan B. Krueger) and the Secretary of Labor (Robert B. Reich).

Volunteer Positions

- **Director of Policy Preparations for Vice Presidential Debate,** Gore-Lieberman Presidential Campaign, September 2000-October 2000. Oversaw policy preparations for Senator Joseph Lieberman before his debate with Republican Vice Presidential candidate Richard Cheney.

- **Volunteer Aide,** Labour Party (London, England), January 1997-May 1997. Advised British Prime Minister Tony Blair's chief political strategist, Philip Gould, on economic issues.

EDUCATION:

- Oxford University, M.Sc. in Economic and Social History, 1997

- Princeton University, A.B. *summa cum laude* in Economics, 1995

- Phillips Exeter Academy, graduate with High Honors, 1991

HONORS, PROFESSIONAL ASSOCIATIONS, AND APPOINTMENTS:

- Corporation for Enterprise Development Leadership Award for "Forging Innovative Public Policies to Expand Economic Opportunity in America," 1999

- Phi Beta Kappa, inducted June 1996

- Marshall Scholar, 1996

- *USA Today* All-USA College Academic Team, 1996.

- Who's Who in America, 2001

- Appointed to the California Workforce Investment Board and the California Governor's Technology Advisory Group.

- Member of the Pacific Council on International Policy, the Los Angeles World Affairs Council, the Asia Society, and the American Economic Association.

RECENT PAPERS AND NOTES:

- "The Process of Economic Policy-Making During the Clinton Administration," with Peter R. Orszag and Laura D. Tyson, in *American Economic Policy in the 1990s*, edited by Jeffrey Frankel and Peter R. Orszag (Cambridge, Massachusetts: MIT Press, forthcoming).

- "Hispanics and the Current Economic Downturn: Will the Receding Tide Sink Hispanics?" with Alan B. Krueger, Pew Hispanic Center, forthcoming.

- "Aging at Home: A Policy Perspective," with Jonathan Gruber and Peter R. Orszag, The Pew Charitable Trusts and Sebago Associates, Inc., forthcoming.

- "Aging in America: A Policy Perspective," with Jonathan Gruber and Peter R. Orszag, The Pew Charitable Trusts and Sebago Associates, Inc., forthcoming.

- "An Economic Analysis of Spectrum Allocation and Advanced Wireless Services," with Martin N. Baily, Peter R. Orszag, and Robert D. Willig, Cellular Telecommunications and Internet Association and Sebago Associates, Inc., October 2001.

- "A New Look at Incentive Effects and Golf Tournaments," in *The Economics of Sports*, edited by Andrew Zimbalist (London: Edward Elgar Publishing, 2001). Original version in *Economics Letters*, 46, March 1994, p. 77-88.

- "Learning and Earning: Working in College," with Peter R. Orszag and Diane M. Whitmore, UPromise, Inc. and Sebago Associates, Inc., August 2001.

- "Paul O'Neill Doesn't Cry for Argentina," Sebago Associates, Inc., August 3, 2001.

- "The Impact of Potential Movie and Television Industry Strikes on the Los Angeles Economy," with Ross C. DeVol, Joel Kotkin, Peter R. Orszag, Robert F. Wescott, and Perry Wong, The Milken Institute and Sebago Associates, Inc., April 19, 2001.

- "Would Raising IRA Contribution Limits Bolster Retirement Security for Lower- and Middle-Income Families?" with Peter R. Orszag, Center on Budget and Policy Priorities, April 2, 2001.

- "Computers in Schools: Domestic and International Perspectives," California Technology, Trade, and Commerce Agency and Sebago Associates, Inc., March 2001.

- "Do You Recognize The Clinton West Wing in *The West Wing*?" *The Atlantic Monthly* Online, March 2001.

- "The Impact of Paying for College on Family Finances," with Laura D. Tyson, Joseph E. Stiglitz, and Peter R. Orszag, UPromise, Inc. and Sebago Associates, Inc., November 2000.

- "A Simple Analysis of Discarded Votes by Precinct in Palm Beach," with Peter R. Orszag, Sebago Associates, Inc., November 10, 2000.

- "Analysis of Votes for Buchanan by Precinct within Palm Beach and Broward Counties," with Peter R. Orszag, Sebago Associates, Inc., November 9, 2000.

- "A Statistical Analysis of the Palm Beach Vote," with Peter R. Orszag, Sebago Associates, Inc., November 8, 2000.

- AThe Role of Government in a Digital Age,@ with Joseph E. Stiglitz and Peter R. Orszag, Computer and Communications Industry Association and Sebago Associates, Inc., October 2000.

- AQuantifying the Benefits of More Stringent Aircraft Noise Regulations,@ with Peter R. Orszag, Northwest Airlines and Sebago Associates, Inc., October 2000.

- AAll That Glitters Is Not Gold: The Feldstein-Liebman Analysis of Reforming Social Security with Individual Accounts,@ with Peter R. Orszag, Center on Budget and Policy Priorities, April 26, 2000.

- "Would Raising IRA Contribution Limits Bolster Retirement Security For Lower- and Middle-Income Families or Is There a Better Way?" with Peter R. Orszag, Center on Budget and Policy Priorities, April 12, 2000.

- "The Economics of the U.S.-China Air Services Decision," with Peter R. Orszag, and Diane M. Whitmore, United Parcel Service and Sebago Associates, Inc., March 2000.

RECENT SPEECHES, TESTIMONY, AND PRESENTATIONS:

- "The Process of Economic Policy-Making During the Clinton Administration," Presentation to the Conference on "American Economic Policy in the 1990s," Center for Business and Government, John F. Kennedy School of Government, and Harvard University, June 29, 2001.

- "The Impact of Paying for College on Family Finances," Presentation to the Conference on "Funding Excellent Schools and Colleges for All Students," National Conference of State Legislatures, February 17, 2001.

- AChina and the Internet,@ Remarks on Entertainment and the Internet in China at the EMASIA 2000 Forum, The Asia Society, May 23, 2000.

- AIs It The Star or Just an Extra? The Role Government Plays in a Digital Economy,@ Remarks on the Regulation of Global Electronic Commerce at the eCommerce and Global Business Forum, The Anderson School at UCLA and the University of Washington Business School, May 18, 2000.

- ALessons Learned from the Emergency Loan Guarantee Programs," Keynote Address at the Government Guaranteed Lending 2000 Conference, Coleman Publishing, Inc., May 4, 2000.

- AThe Department of Commerce Fiscal Year 2001 Budget and Its Native American Initiatives,@ Testimony to the United States Senate Indian Affairs Committee, February 23, 2000.

- ATestimony on S. 614: The Indian Tribal Regulatory Reform and Business Development Act,@ Testimony to the United States Senate Indian Affairs Committee, May 19, 1999.

- Remarks to the Assembly of Phillips Exeter Academy, Exeter, New Hampshire, February 9, 1999.

PETER RICHARD ORSZAG

Peter R. Orszag is President of Sebago Associates, Inc., an economic consulting firm. Dr. Orszag also serves as the Joseph A. Pechman Senior Fellow in Tax and Fiscal Policy at The Brookings Institution. He previously served as Special Assistant to the President for Economic Policy at the White House, as Senior Economist and Senior Adviser on the President's Council of Economic Advisers, as an economic adviser to the Russian Government, and as an adjunct member of the economics faculty at the University of California at Berkeley. Dr. Orszag earned his B.A. from Princeton University, and an M.Sc. and Ph.D. in economics from the London School of Economics, which he attended as a Marshall Scholar.

PROFESSIONAL EXPERIENCE

- Senior Fellow in Economic Studies, The Brookings Institution (Washington, DC), August 2001-; Joseph A. Pechman Fellow in Tax and Fiscal Policy, October 2001-. Current projects include work on Social Security and higher education. Areas of expertise include aging, budget policy and politics, climate change, demographics, education policy, income distribution, financial markets, macroeconomics, pensions, poverty, privatization, Social Security, and tax policy.

- President, Sebago Associates, Inc. (Belmont, CA), August 1998-. Founded public policy consulting firm to provide analytical support and advice to both the public and private sectors. Clients have included the Securities and Exchange Commission, Social Security Administration, World Bank, Nordic Council of Ministers, Governor of California, Mayor of Los Angeles, Central Bank of Iceland, Government of Trinidad and Tobago, and firms ranging from small businesses to the Fortune 500.

- Lecturer, University of California, Berkeley (Berkeley, CA), January 1999-December 2000. Taught the intermediate macroeconomics course to 300-350 undergraduates. Supervised six to eight teaching assistants.

- Consultant, McKinsey & Company (San Francisco, CA), June 1998-August 1998. Advised one of the nation's largest HMOs on developing its 1999 budget and redesigning its budget process.

- Special Assistant to the President for Economic Policy, National Economic Council (The White House), November 1997-May 1998; Senior Economic Advisor, January 1997-October 1997. Served as top economic advisor to the NEC Director. Portfolio included Social Security, climate change, macroeconomic analysis, electricity restructuring, personal bankruptcy reform, privatization of the U.S. Enrichment Corporation, and a variety of other economic issues.

- Senior Adviser to the Council, Council of Economic Advisers (Executive Office of the President), May 1996-November 1996; Senior Economist, July 1995-May 1996.

As the senior staff member of the Council, wrote the 1996 *APEC Economic Outlook*; wrote and edited sections of the *Weekly Economic Briefing of the President* and the *Economic Report of the President*; and represented the United States at international meetings, including APEC and the OECD.

- Professional Research Staff, Centre for Economic Performance (London School of Economics), October 1994-June 1995. Member of International Finance, Capital Markets, and Macroeconomic research groups.

- Staff Economist, Council of Economic Advisers, August 1993-July 1994. Areas of concentration included international macroeconomics, international trade, and the reform process in the former Soviet Union.

- Economic Adviser, Macroeconomic and Fiscal Unit (Ministry of Finance, Russian Government), January 1993-August 1993. Assisted the Russian Government in its negotiations with the International Monetary Fund.

- Research Officer, Centre for Economic Performance, September 1992-August 1993. Wrote *Russian Economic Trends*, the quarterly report of the Russian Government.

EDUCATION

- London School of Economics, Ph.D. in Economics, March 1997. Thesis: *Dynamic Analysis of Regime Shifts Under Uncertainty: Applications to Hyperinflation and Privatization*

- London School of Economics, M.Sc. in Economics with Distinction, June 1992

- Princeton University, A.B. *summa cum laude* in Economics, June 1991

- Phillips Exeter Academy, graduate with High Honors, June 1987

HONORS AND PROFESSIONAL ASSOCIATIONS

- Phi Beta Kappa, inducted June 1991

- John Glover Wilson Memorial Prize in Economics at Princeton University, June 1991

- Marshall Scholar, 1991-2

- M.Sc. Economics Prize at the London School of Economics, June 1992

- Member of the National Academy of Social Insurance and Pacific Council on International Policy

- Research Associate, Center for Retirement Research, Boston College

RECENT PAPERS, TESTIMONY, AND NOTES (1999-)

- "Individual Accounts in the United Kingdom: Lessons for the United States," Testimony before the Ways and Means Committee, U.S. House of Representatives, February 11, 1999

- "Federal Debt: What Matters and Why," (with Robert Greenstein), Center on Budget and Policy Priorities, February 1999

- "Individual Accounts and Social Security: Does Social Security Really Provide a Lower Rate of Return?" Center on Budget and Policy Priorities, March 1999

- "The Impact of Individual Accounts: Piecemeal vs. Comprehensive Approaches," (with J. Michael Orszag, Dennis J. Snower, and Joseph E. Stiglitz), Annual Bank Conference on Development Economics, The World Bank, April 1999

- "Administrative Costs in Individual Accounts in the United Kingdom," Center on Budget and Policy Priorities, March 1999

- "The Social Security Earnings Test: An Overview and Examination of Reform Options," (with Jonathan Gruber), presented at the First Annual Joint Conference for the Retirement Research Consortium, Washington, May 1999

- "Comments on Stefan Dercon, 'Safety nets, savings and informal social security systems in crisis-prone economies'," ABCDE Europe Conference, Paris, June 1999

- "What To Do About the Social Security Earnings Test," (with Jonathan Gruber), Issue in Brief Number 1, Center for Retirement Research, Boston College, July 1999

- "The Value for Money of Annuities in the UK: Theory, Experience, and Policy," (with Mamta Murthi and J. Michael Orszag), August 1999, presented at the World Bank Conference, "New Ideas About Old Age Security," September 1999

- "Population Dynamics and Convergence in Fertility Rates," (with Tryggvi Thor Herbertsson and J. Michael Orszag), Birkbeck College Working Paper 99-13, University of London, October 1999

- "Exacerbating Inequities in Pension Benefits: An Analysis of the Pension Provisions in the Tax Bill," (with Iris Lav and Robert Greenstein), Center on Budget and Policy Priorities, October 1999

- "Criticism of CBPP Pension Analysis Rests on Selective Use of Data And Leaves Misleading Impressions," (with Iris Lav and Robert Greenstein), Center on Budget and Policy Priorities, October 1999

- "Annuity Costs in the UK," (with Mamta Murthi and J. Michael Orszag), Centre for Pensions and Social Insurance, University of London, January 2000

- "Privatization of the U.S. Enrichment Corporation: An Economic Analysis," presented at the Brookings Institution, February 2000

- "How the 'Cross-Testing' Pension Loophole Harms Low- and Moderate-Income Workers," Center on Budget and Policy Priorities, March 2000

- "Pension Provisions of Tax Bill Coming to House Floor Would Heavily Benefit Highly Paid Executives and Business Owners But Could Jeopardize Pension Benefits for Ordinary Workers," (with Iris Lav and Robert Greenstein), Center on Budget and Policy Priorities, March 2000

- "Would Raising IRA Contribution Limits Bolster Retirement Security For Lower- and Middle-Income Families or Is There a Better Way?" (with Jonathan M. Orszag), Center on Budget and Policy Priorities, April 2000

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JOHN M. GALE

John M. Gale received his B.S. in economics and physics from Beloit College, and his M.S. and Ph.D. in economics from the University of Wisconsin-Madison. Prior to joining *The Brattle Group*, Dr. Gale was an economic consultant with Charles River Associates and taught economics and finance at The Mississippi University for Women.

Dr. Gale specializes in antitrust, industrial organization, and microeconomic theory. His research includes price-war modeling and the application of game theoretic models to qualitative aspects of specific markets. His most recent research has included econometric analysis and modeling of unilateral price effects of mergers in differentiated product markets. In addition, Dr. Gale has modeled merger effects in electricity markets and markets with auctions.

Dr. Gale has experience in all phases of economic litigation and large-scale project management. He has consulted to clients in numerous industries including telecommunications (cable television set-top boxes, television distribution and programming, digital radio, mobile communications), newspaper publishing, financial information services, consumer products (paper products, beer, feminine hygiene, candy, water purification), biotechnology (genetically altered hybrid corn), and professional services (accounting services, hospitals). Dr. Gale has preformed analysis on a wide variety of economic issues, including mergers, price fixing, attempted monopolization, damages estimation, and regulatory matters. Recent projects include:

- On behalf of Reuters, Dr. Gale analyzed the effects on the financial information services market of the acquisition of certain assets from Bridge Information Systems during a review by the Antitrust Division of the Department of Justice.

- For a wireless telecommunications firm attempting to renegotiate a merger consent decree with the U.S. Department of Justice, Dr. Gale analyzed wireless communications market definition and competition, modeled competitive effects of entry and exit, and assisted in drafting an expert report. The analysis detailed the entry of new wireless telecommunications providers, the changing regulatory position of the Federal Communications Commission, and the rapid technological change that was affecting the industry.

- For a number of consumer product companies, Dr. Gale has modeled unilateral price effects of proposed mergers based on analysis of Nielsen retail sales data. This has included econometric estimation of substitutability between products and modeling the predicted price effects of merger or changes in cross-ownership. Dr. Gale has participated in presentations of the data, methodology, and results to the Federal Trade Commission and Antitrust Division of the U.S. Department of Justice.

- For a newspaper publisher in Northwest Arkansas, Dr. Gale analyzed advertising and subscriber data to determine the degree of market overlap between two regional daily newspapers. In addition, Dr. Gale conducted advertiser interviews to determine the market overlap of the regional daily newspapers with direct mail, a statewide daily newspaper, and local weekly newspapers. Dr. Gale assisted in the preparation of expert reports and testimony on behalf of the client.

- On behalf of General Instrument Corporation, Dr. Gale co-authored two filings submitted to the Federal Communications Commission on the issue of mandating the retail availability of cable set-top boxes. The analysis applied current economic theory on network industries to predict the effects on suppliers and consumers of television programming.

- On behalf of USA Digital Radio, Dr. Gale co-authored a filing submitted to the Federal Communications Commission advocating the involvement of the Commission in standard setting for digital radio in order to solve coordination problems between broadcasters, radio transmission equipment manufacturers, and consumer radio receiver manufacturers.

- On behalf of Saudi Arabian Texaco, Dr. Gale assisted in the preparation of a lost assets damage analysis filed with the United Nations for drilling, lifting, and refinery assets destroyed during the Iraqi invasion of Kuwait. This analysis entailed the valuation of assets in the Neutral Zone between Kuwait and Saudi Arabia, some of which were jointly owned and operated by Texaco and the Kuwaiti government, using very limited documentary evidence.

- For a provider of accounting services, Dr. Gale prepared a bidding model of competition to provide services to Fortune 1000 clients. In addition, Dr. Gale determined the degree of accounting client overlap among different providers of accounting services.

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