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before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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In the Matter of:	)	
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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 DIRECTV, INC.

DIRECTV, Inc. ("DIRECTV") hereby offers the following reply comments in connection with the Commission's Notice of Proposed Rulemaking in the above-captioned proceeding ("Notice").

I. OVERVIEW AND SUMMARY

The Comments in this proceeding have broken down along predictable lines. On the one hand, a few of the nation's largest incumbent cable operators argue that Section 628(c)(2)(D)'s restriction on exclusive contracts between cable operators and vertically integrated programmers has outlived its usefulness.[1] On the other hand, a strong chorus of every other type of competitive multichannel video programming distributor ("MVPD") – consisting of existing and

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[1] *See* Comments of AOL Time Warner (Dec. 3, 2001); Comments of AT&T Corp. (Dec. 3, 2001); Comments of Cablevision Systems Corporation (Dec. 3, 2001); Comments of Comcast Corporation (Dec. 3, 2001); Comments of The National Cable Television Association (Dec. 3, 2001).

prospective satellite providers,[2] small cable companies,[3] telephone companies and other cable overbuilders,[4] and current and prospective broadband services providers[5] – explains that there is a strong, continuing need for this provision in order to preserve and expand MVPD competition.

The basic position of "Big Cable" in this proceeding, common to each of the incumbent cable operator filings, is presented in two discrete steps. First, we are reminded that exclusivity is an ordinary, pro-competitive business practice that historically has been favored by Congress and the Commission;[6] second, we are assured that the MVPD market is flourishing and vibrantly competitive, such that it is irrational to fear that exclusive agreements could or would be wielded by incumbent cable operators in an anticompetitive fashion.[7]

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2 *See* Comments of DIRECTV, Inc. (Dec. 3, 2001); Comments of EchoStar Communications Corporation (Dec. 3, 2001); Comments of World Satellite Network, Inc. (Dec. 3, 2001).

3 *See* Comments of American Cable Association (Dec. 3, 2001).

4 *See* Comments of Qwest Broadband Services, Inc. (Dec. 3, 2001); Comments of RCN Telecom Services, Inc. (Dec. 3, 2001); Comments of Rural Independent Competitive Alliance (Dec. 3, 2001); Comments of Seren Innovations, Inc. (Dec. 3, 2001).

5 *See* Comments of the Competitive Broadband Coalition (Dec. 3, 2001); Comments of Everest Midwest Licensee LLC (Dec. 3, 2001).

6 *See, e.g.,* Comments of AOL Time Warner Inc. at 14-16 (arguing that "[t]erritorial exclusivity has long been recognized as a legitimate practice that enhances program diversity," and that "Congress recognized the pro-competitive benefits of exclusive contracts in enacting the program access rules"); Comments of AT&T Corp. at 7 (discussing the many "pro-competitive reasons why suppliers and their distributors may enter into exclusive contracts"); Comments of Comcast Corporation at 13 (extolling the "general benefits of exclusivity in vertical relationships").

7 *See, e.g.,* Comments of AOL Time Warner Inc. at 7 (alleging that "[w]hatever the merits the exclusivity provision may have had in promoting competition in the past, it is evident that competition in the distribution of programming today it is vigorous and robust"); Comments of AT&T Corporation at 19 (characterizing MVPD market as "highly competitive," which "confirms" that the statutory presumption against program exclusivity is "obsolete"); Comments of Comcast at 4 (proclaiming that the "prohibition is no longer necessary to preserve and protect competition and diversity because both supply and distribution in MVPD markets are flourishing and have surpassed the level of competitiveness Congress could have envisioned in 1992"); Comments of the National

It is worth noting at the outset that these arguments are *identical* to the cable industry positions that were considered and expressly rejected by Congress and the Commission when the program access law was enacted in 1992. And the blithe assurances of incumbent cable operators that Section 628(c)(2)(D) is no longer necessary ring just as hollow today.

In these Reply Comments, DIRECTV responds to the cable operator arguments, with reference to the attached analysis of the continuing need for Section 628(c)(2)(D), "An Economic Assessment of the Exclusive Contract Prohibition Between Vertically Integrated Cable Operators and Programmers," authored by economists Jonathan Orszag, Peter Orszag and John Gale.[8] Among other findings, these economists conclude that:

- The concerns about the possible anticompetitive effects that can arise from the linkage of vertical integration and exclusive contracts that motivated Congress to enact Section 628(c) are confirmed by economic theory, and the key determinant of whether vertical integration and exclusive contracts can be used for anticompetitive foreclosure is "is the degree of market power: anticompetitive exclusivity is possible in markets that are not fully competitive."[9]

- Despite cable operator 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 [Section 628(c)(2)(D)'s] prohibition therefore has not significantly changed – especially given the trend toward horizontal consolidation in the cable industry and the introduction of digital cable."[10]

- The claims by cable operator advocates that foreclosure incentives do not exist are belied by, among other things, the willingness of dominant cable operators to

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Cable Television Association at 4 (asserting that cable faces "strong competition in the distribution of video programming").

8 J. Orszag, P. Orszag and J. Gale, "An Economic Assessment of the Exclusive Contract Prohibition Between Vertically Integrated Cable Operators and Programmers" (Jan. 2002) ("Orszag, Orszag & Gale"), attached hereto as Exhibit 1.

9 *Id.* at 4.

10 *Id.*

utilize the economically unjustified loophole of terrestrial distribution to bypass program access provisions.[11]

- The potential costs cited by dominant cable operators of retaining Section 628(c)(2)(D) are outweighed by the provision's benefits, as evidenced by the dramatic increase in program diversity that has occurred since the provision's enactment, and the fact that the prohibition has not significantly discouraged vertical integration in the cable industry. In addition, Section 628(c)(2)(D) by its terms contains a mechanism for cable operator exclusive arrangements to be approved where they are found to be in the public interest.[12]

The authors' ultimate conclusion is that, "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."[13] DIRECTV agrees.

II. THE CABLE OPERATORS' GENERAL EXHORTATIONS REGARDING EXCLUSIVE DEALING PRACTICES FAIL TO ADDRESS THE QUESTION OF WHETHER THE PRESUMPTION AGAINST EXCLUSIVE ARRANGEMENTS BETWEEN CABLE OPERATORS AND VERTICALLY INTEGRATED PROGRAMMERS SHOULD SUNSET

The efforts of the cable industry to emphasize the fact that exclusivity is "a common business tool that promotes consumer welfare"[14] miss the point entirely. As the large cable operators themselves point out, the general benefits of exclusivity they cite were expressly acknowledged during the enactment and implementation of the exclusivity prohibitions of Section 628(c)(2): the Commission noted, for example, that "[a]s a general matter, the public

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11 *Id.* at 5.

12 *See id.* at 4-5.

13 *Id.* at 5.

14 Comments of Cablevision Systems Corp. at 5-6. *See also* Comments of AOL Time Warner Inc. at 14-16 (arguing that "[t]erritorial exclusivity has long been recognized as a legitimate practice that enhances program diversity," and that "Congress recognized the pro-competitive benefits of exclusive contracts in enacting the program access rules"); Comments of AT&T Corp. at 7 (discussing the "pro-competitive reasons why suppliers and their distributors may enter into exclusive contracts"); Comments of Comcast Corporation at 13 (extolling the "general benefits of exclusivity in vertical relationships").

interest in exclusivity in the sale of entertainment programming is widely recognized."[15] This general point has never been in question.

The issue at the heart of this proceeding, however, is whether the conditions that led Congress and the Commission to enact and implement Section 628(c)(2)(D) have fundamentally changed. When the Commission first implemented the protections of the program access law, it observed:

> The legislative history of Section 628 specifically, and of the 1992 Cable Act in general, reveals that Congress was concerned with market power abuses exercised by cable operators and their affiliated program suppliers that would deny programming to non-cable technologies. . . Congress expressly declared its policy to "ensure that cable television operators do not have undue market power vis-à-vis video programmers and consumers." Congress found that, as a result of increased vertical integration between cable operators and cable programmers, "cable operators have the incentive and ability to favor their affiliated programmers" and "vertically integrated program suppliers also have the incentive and ability to favor their affiliated cable operators over non-affiliated cable operators and programming distributors using other technologies."[16]

The Commission further found that "the legislative history of Section 628(c)(2)(C) more particularly illustrates congressional concern over cable operators' use of exclusivity to stifle competition from other technologies."[17]

Thus, while Cablevision may be correct for example, in stating that "[o]utside of the cable industry, the antitrust laws are considered sufficient to guard against competitive abuses,"[18]

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15 *In the Matter of Implementation of Sections 12 and 19 of the Cable Television Consumer Protection Competition Act of 1992*, First Report and Order, 8 FCC Rcd 3359 (1993) ("Program Access Report and Order"), ¶ 63.

16 *In the Matter of Implementation of Sections 12 and 19 of the Cable Television Consumer Protection Competition Act of 1992,* Memorandum Opinion and Order on Reconsideration of the First Report and Order, 10 FCC Rcd 3105, 3123 (1994), ¶ 35 (citations omitted).

17 *Id.* at ¶ 36.

the point is a truism and irrelevant. Title VI and Section 628 generally, and Section 628(c)(2)(D) specifically, were enacted for sound public policy reasons. As Orszag, Orszag and Gale suggest, economic theory supports the potential of anticompetitive behavior engendered by the combination of cable operator exclusive contracting and vertical integration that is reflected in the provisions of Section 628(c)(2).[19] The analysis as to whether such concerns are now sufficiently attenuated to warrant the provision's sunset is a market-specific inquiry that cannot be addressed by generalities or conclusory platitudes.

III. THE FEW DOMINANT INCUMBENT CABLE OPERATORS THAT SUPPORT THE SUNSET OF SECTION 628(C)(2)(D) PRESENT NO PERSUASIVE EVIDENCE THAT MARKET CONDITIONS HAVE CHANGED SO FUNDAMENTALLY AS TO OBVIATE THE NEED FOR THE PROVISION

When the 1992 Cable Act was enacted, cable operators dominated approximately 96% of the MVPD market. Today, nearly ten years later, cable operators still continue to dominate approximately 80% of the MVPD market.[20] To be sure, DBS providers such as DIRECTV have made significant competitive inroads into cable's market dominance, and have begun to exert some downward pressure on cable pricing and to stimulate cable upgrades and innovation. But the characterization of the current MVPD marketplace as "vigorously" and "fully" competitive, proffered by a handful of dominant cable incumbents, is dramatically overstated.

The fact is that cable operators continue to exert undue MVPD market power today, and this market power may increase in the future. As Orszag, Orszag and Gale observe:

> 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

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18 Comments of Cablevision Systems Corp. at 2.

19 *See Orszag, Orszag & Gale* at 7-14.

20 *See, e.g.,* Comments of The National Cable & Telecommunications Association, CS Docket No. 01-129 (Aug. 2, 2001), at ¶ 7.

> 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 Internet access, video-on-demand, and other advanced services – all of which the DBS firms currently have difficulty matching.[21]

To the extent that cable market power was one of the fundamental premises underlying the exclusive contract prohibition of Section 628(c), the authors conclude that, contrary to the contention of large cable operators, cable firms "continue to have enough market power to have incentives to foreclose access to programming and harm competition and consumers."[22]

Furthermore, Orszag, Orszag and Gale debunk the cable operators' claim that the entry of new independent programming into the MVPD marketplace has significantly weakened their ability to effectively foreclose access to enough programming to have anticompetitive effects.[23] For example, although NCTA asserts that over the past decade the percentage of vertically integrated programming services has declined, Orszag, Orszag and Gale note that "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. 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. The lack of close substitutes for

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21 *Orszag, Orszag & Gale* at 15-16.

22 *Id.* at 17.

23 *See, e.g.*, Comments of AOL Time Warner, Inc. at 18; Comments of AT&T Corp. at 19-22; Comments of Cablevision Systems, Inc. at 30-31.

> these top channels facilitates the effectiveness of anticompetitive foreclosure.[24]

In addition, horizontal consolidation in the cable industry – which has been the strong trend, reflected most recently in the announcement of Comcast's proposed acquisition of AT&T Broadband – increases the incentives for anticompetitive foreclosure of access to integrated programming. Orszag, Orszag and Gale point out that the "larger the size of the integrated cable firm's potential subscriber base, the larger the potential benefit from foreclosing access to programming."[25]

Finally, other market evidence clearly suggests that, in the absence of restrictions on exclusive arrangements between cable operators and vertically integrated programmers, incumbent cable interests will be quite likely to withhold access to programming that is vital for competing MVPDs to succeed. For example, RCN, DIRECTV and EchoStar have all recounted the exploitation by Comcast of a loophole in the program access law that to date has permitted Comcast to avoid the application of Section 628 and thereby withhold vitally important regional sports programming from its MVPD competitors in Philadelphia.[26] According to Comcast, the

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24 *Orszag, Orszag & Gale* at 17-18 (citations omitted).

25 *Id.* at 19.

26 *See, e.g.,* Comments of DIRECTV, Inc., CS Docket No. 01-129 (Aug. 3, 2001), at 8-10; Comments of EchoStar Satellite Corporation at 10-11, 24-25; Initial Comments of RCN Telecom Services, Inc. at 11-19, 29-35. *See also In the Matter of DIRECTV, Inc. and EchoStar Communications Corp. v. Comcast Corp.*, Memorandum Opinion and Order, 15 FCC Rcd 22,802 (2000), *petition for review pending sub nom., EchoStar Communications Corp. v. FCC*, No. 01-1032 (D.C. Cir.) (argument scheduled Feb. 5, 2002). Cablevision evidently has engaged in similar conduct. *See RCN Telecom Services of New York, Inc. v. Cablevision System Corp.*, 14 FCC Rcd 17,093 (CSB 1999), *aff'd*, Memorandum Opinion and Order, 16 FCC Rcd 12,048 (rel. May 20, 2001).

ability to withhold Comcast SportsNet from competing MVPDs has provided "a significant marketing advantage against satellite and other competitors."[27]

Orszag, Orszag and Gale, in examining this scenario, observe that "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."[28] And they note further:

> 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. 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.[29]

Conditions in the MVPD marketplace simply do not warrant elimination or modification of Section 628(c)(2)(D). The competitive concerns that led Congress to presumptively restrict exclusive contracts between cable operators and vertically integrated programmers remain valid today.

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27 *See Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming*, CS Doc. 00-132 (rel. Jan. 2, 2001) ("*2000 Competition Report*"), ¶ 186.

28 *Orszag, Orszag & Gale* at 22. The authors also explain in that there is no economic justification for the terrestrial loophole in the program access law that Comcast has exploited. *Id.* at 30.

29 *Id.* at 23 (footnote omitted).

IV. THE COMMISSION HAS AN AMPLE LEGAL AND EVIDENTIARY BASIS TO RETAIN SECTION 628(C)(2)(D)

Section 628(c)(5) requires the Commission to conduct the instant proceeding. It states that the exclusive contract prohibition of Section 628(c)(2)(D) "shall cease to be effective" unless the Commission finds that the prohibition "continues to be necessary to preserve and protect competition and diversity in the distribution of video programming."[30]

Focusing on the word "necessary," AOL Time Warner suggests that the above-quoted language of Section 628(c)(5) creates a "statutory presumption" that Section 628(c)(2)(D) must be lifted absent the presentation of "substantial and specific evidence establishing that, without retention, competition and diversity in the distribution of video programming could not be preserved and protected." [31] This is a misreading of the statutory language and a mischaracterization of Congressional intent.

Specifically, the finding that the Commission is charged to make in Section 628(c)(5) is whether Section 628(c)(2)(D) "*continues* to be necessary."[32] In other words, the logical reading of this text is that Congress *already* has presumed in its threshold enactment of Section 628 that the Section 628(c)(2)(D) exclusivity prohibition is "necessary" to preserve and protect competition and diversity in the distribution of video programming, and the Commission now must examine whether that condition "continues" to be the case. This inquiry does not require the Commission to prove a negative, *i.e.*, that competition and diversity cannot under any circumstances be protected in the absence of Section 628(c)(2)(D),[33] nor does it require the Commission to lift Section 628(c)(2)(D) unless "extraordinary circumstances" convince the

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30 47 U.S.C. § 548(c)(5).

31 Comments of AOL Time Warner, Inc. at 3.

32 47 U.S.C. § 548(c)(5) (emphasis added).

33 *Id.*

Commission that it is necessary to retain the prohibition, as AT&T contends.[34] Instead, subject to ordinary principles of review under the Administrative Procedure Act, the Commission is obligated to exercise its predictive judgment in this proceeding based upon its examination of record evidence, economic analysis, and other relevant data. As discussed previously, when such factors are assessed, the conclusion is compelling that cable operators continue to dominate the MVPD market in 2002, as they did ten years ago, and that Section 628(c)(2)(D) "continues" to be a "necessary" protection to preserve and promote competition and diversity in the multichannel video marketplace.[35]

V. CONCLUSION

For the foregoing reasons, the Commission should retain Section 628(c)(2)(D). It remains a relevant and important provision that will promote competition and diversity in today's MVPD market.

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34 *See* Comments of AT&T Corp. at 5.

35 AOL Time Warner's attempt to further argue that Section 628(c)(2)(D) is unconstitutional on first amendment grounds is similarly without merit. Comments of AOL Time Warner, Inc. at 5-6. AOL Time Warner itself notes that the D.C. Circuit, applying intermediate scrutiny, rejected its facial constitutional challenge to Section 628 in 1996. *See Time Warner Entertainment Co. L.P. v. FCC*, 93 F.3d 957, 979 (D.C. Cir. 1996). AOL Time Warner provides no persuasive basis for predicting that a court would or should decide the issue differently here.

Respectfully submitted,

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