111. The third largest BSP is Knology, an overbuilder based in Knoxville, Tennessee, which operates in the Southeast. As of June 30, 2001, Knology was the 26th largest MVPD provider (excluding satellite) with 110,100 subscribers,[400] and served cities in Alabama, Florida, Georgia, Tennessee, and South Carolina.[401] Knology has acquired or is building systems in additional areas of Tennessee and Kentucky, including Knoxville and Nashville.[402]

112. Grande Communications has franchises in more than 30 Texas cities, and has launched service in Austin, San Marcos, and San Antonio, Texas.[403] Western Integrated Networks ("WIN") recently received a franchise to build a system to serve 1.4 million households in Los Angeles.[404] WIN has franchise applications pending in Seattle, Washington; Portland, Oregon; San Francisco and Oakland, California; Las Vegas, Nevada; Phoenix, Arizona; and San Antonio, Austin, Dallas, and Houston, Texas.[405] Altrio Communications secured $125 million in an initial round of financing and seeking franchises serving Los Angeles and surrounding communities.[406] Finally, Carolina Broadband has plans to serve Charlotte, Raleigh/Durham, and Winston-Salem/Greensboro, North Carolina, and Columbia and Greenville/Spartanburg, South Carolina.[407]

113. ***OVS.*** Several BSPs, including some that are CLECs, operate open video systems, hold OVS certifications, or hold local OVS franchises.[408] RCN is by far the largest OVS operator in the country (and the only operational one), both in terms of certifications and in number of subscribers. RCN operates open video systems in the five boroughs of New York City, in Washington, D.C., and in a few small communities around Boston.[409] RCN reports that speed to market is crucial for it, so that RCN will

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[400] Paul Kagan Assoc., Inc., *Top Cable System Operators as Of 6/30/01 (By Basic Subs)*, Cable TV Investor, Aug. 29, 2001, at 12.

[401] Knology, Inc., at http://www.knology.com/cities/index.cfm. According to its Web site, Knology serves Gunter Air Force Base, Harvest, Huntsville, Lanett, Madison, Maxwell Air Force Base, Montgomery, Pike Road, Prattville, Redstone Arsenal, and Valley, Alabama; Lynn Haven, Panama City, and Panama City Beach, Florida; Augusta, Columbus, Evans, Forest Hills, Grovetown, Martinez, Midland, and West Point, Georgia; Knoxville, Tennessee; and Charleston, Ladson, Mount Pleasant, North Charleston, and Summerville, South Carolina.

[402] *Id.*

[403] Grande Communications, Inc., *About Grande*, at http://www.grandecomm.com/About/GRD_Milestones.pdf. *See also* NCTA Comments at 23. *See* ¶ 106 *infra* for information on Grande's partnership with Reliant Energy to provide service to Houston. The Commission has pending effective competition petitions before it regarding Grande Communication's activities in Austin and San Antonio. *See* CSR 5701-E and CSR 5721-E.

[404] Sallie Hofmeister, *L.A. Council OKs Cable Competition*, Los Angeles Times, July 25, 2001. WIN plans to begin construction sometime during 2001, and begin service 12 to 18 months after the start of construction. In the franchise agreement, WIN committed to completing construction in one franchise area by 2005 (Los Angeles is divided into many franchise areas), and to complete half the system construction by 2007.

[405] NCTA Comments at 22.

[406] Altrio Communications, *Altrio Communications Enters the Los Angeles Telecommunications Market* (press release), Oct. 25, 2000. *See also* NCTA Comments at 22.

[407] Carolina Comments at 1.

[408] For a complete listing of approved, pending, and denied applications for OVS certification, *see* http://www.fcc.gov/csb/csovscer.html.

[409] Telephone interview with Scott Burnside, Senior Vice President, Regulatory & Government Affairs, RCN (Nov. 15, 2001).

adopt the regulatory approach (OVS agreement, OVS franchise, or Title VI franchise) most amenable to the local franchising authorities.[410] RCN also reports that it has received "numerous expressions of interest" from potential video programming packagers, but none has signed up yet for service.[411]

114. ***Barriers to Competition.*** Several BSPs filed comments in this proceeding reporting barriers to competition in the MVPD market. RCN reports that it still is unable to gain access to programming due to migration to terrestrial delivery. In particular, RCN states that it cannot access local sports programming in the New York City and Philadelphia markets.[412] RCN believes that the cable industry, recognizing the essential nature of local sports programming for MVPD entrants, has "...adopted ownership or control of local sports programming as a device to capture or assure dominance in local markets."[413] RCN further indicates that the program access prohibition on exclusivity is "absolutely vital" for the future of competition.[414]

115. BSPs also noted problems in delivering programming to subscribers. First, BSPs indicate that they are having problems gaining access to utility poles so that they can build out their systems.[415] Second, BSPs are having difficulty offering service to MDUs, especially in cases where cable operators have exclusive contracts with MDUs.[416] WOW reports difficulties in obtaining franchises due to opposition from incumbent providers.[417] WOW also alleges that incumbent cable operators engage in predatory pricing and marketing discrimination practices.[418] RCN believes that "...clustering of cable ownership is driven principally by the desire to reinforce dominance in a particular market."[419] Finally, Carolina indicates that, if the Commission does not act to remove these barriers to competition, BSPs will be unable to gain access to capital and thus compete against incumbent cable operators.[420]

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[410] RCN Comments at 23.

[411] *Id.* at 24.

[412] *Id.* at 9-12.

[413] *Id.* at 12.

[414] *Id.* at 13-16. RCN urges the Commission to establish, either in place of or in addition to the regular review of the exclusivity prohibition, some sort of industry forum on the issue. *See also* Carolina Comments at 10-12; WOW Reply Comments at 7-10. In opposition, cable industry comments indicate that the exclusivity prohibition should be allowed to sunset on schedule because competition is well-established, and because exclusivity contracts "...can serve as a spur to investment, creativity, and responsiveness to emerging audience wishes." Comcast Reply Comments at 17-22. *See also* Cablevision Reply Comments at 6-7; NCTA Comments at 34-39.

[415] RCN Comments at 16-20; Carolina Comments at 6-7.

[416] RCN Comments at 21.

[417] WOW Reply Comments at 6-7. *See also* RCN Comments at 22-23.

[418] WOW Reply Comments at 10-12.

[419] RCN Comments at 24-25.

[420] Carolina Comments at 5.

III. MARKET STRUCTURE AND CONDITIONS AFFECTING COMPETITION

A. Horizontal Issues in the Market for the Delivery of Video Programming

116. The video programming market is comprised of two separate but related markets: (a) the market for the distribution of multichannel video programming to households, and (b) the market for the purchase of video programming by MVPDs. For purposes of assessing the impact of horizontal concentration, it is appropriate to examine both the national programming market and the local distribution market because cable operators generally acquire programming on the national level and distribute it on the local level through their locally franchised systems.[421] In the distribution market, the buyers are individual households as well as families living in MDUs, and the sellers are MVPDs, including cable operators and other video service providers such as DBS providers. In the market for the purchase of video programming, the buyers are MVPDs, and the sellers are programming networks, studios and programming packagers.[422]

117. In this section, we first review changes in the market for the distribution of video programming, including changes in the level of competition in that market between July 2000 and June 2001. In our discussion of competition in the distribution of video programming to households, we also examine developments unique to MDUs, a significant sub-set of the market. We then review the market for the purchase of video programming by MVPDs, and examine the effects that changes in concentration among MVPDs at the regional and national levels have had on this market in the last year.

1. Competitive Issues in the Market for the Distribution of Video Programming

118. The market for the delivery of video programming to households continues to be highly concentrated and characterized by substantial barriers to entry.[423] These barriers may include: (a) strategic behavior by an incumbent designed to raise its rival's costs, e.g., limiting the availability to rivals of certain popular programming as well as equipment; (b) local and state level regulations, e.g., causing new entrants to incur a delay in gaining access to local public rights-of-way facilities; and (c) technological limitations, e.g., DBS and MMDS line-of-sight problems.[424]

119. While competitive satellite alternatives to the incumbent wireline MVPDs are developing and attracting an increasing proportion of MVPD subscribers, most consumers have limited choices among video distributors. A relatively small percentage of consumers have a second wireline alternative, such as an OVS or overbuild cable system. Among the several wireless technologies used to provide video programming service, DBS is the only wireless technology currently available to a majority of subscribers nationwide. Thus, homes are generally passed by only one wireline cable operator and the two major DBS providers, DirecTV and EchoStar. On October 28, 2001, General Motors Corp. and its

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[421] *See Implementation of Section 11(c) of the Cable Television Consumer Protection and Competition Act of 1992, Horizontal Ownership Limits,* MM Docket No. 92-264, Memorandum Opinion and Order on Reconsideration and Further Notice of Proposed Rulemaking, 13 FCC Rcd at 14477 (1998).

[422] *See 1997 Report*, 13 FCC Rcd at 1107-8 for a description of the relevant market.

[423] *See* Carolina Comments at 4-9, 13; RCN Comments at 16-21, 24-25.

[424] *See* Carolina Comments at 5-12; RCN Comments at 9-23; Utilicorp, Comments at 4-8. *See also 1994 Report,* 9 FCC Rcd at 7550-56 for a description of impediments to competition.

subsidiary Hughes Electronics (DirecTV) together with EchoStar announced the signing of definitive agreements that provide for the spin-off of Hughes from GM and the merger of Hughes with EchoStar.[425] This transaction is currently pending before the Commission and the United States Department of Justice.[426]

120. Of the 33,000 cable community units nationwide, 419, or approximately one percent have been certified by the Commission as having effective competition as a result of consumers having a choice of more than one MVPD. As we show in the Competitive Response section below, incumbent operators are most likely to respond to competition by reducing their monthly charge for cable programming services and equipment, by offering additional channels, or by offering Internet and other telecommunications services.[427]

121. Several wireless MVPD technologies, including MMDS, SMATV, and DBS, deliver programming to individual households and MDUs, and provide consumers an alternative to incumbent cable systems.[428] While wireless technology in general provides an alternative to some cable subscribers, SMATV and MMDS may not be able to provide services similar to that provided by an incumbent cable operator. For example, the service area covered by a SMATV system usually includes only a small portion of a cable system's franchise area. MMDS systems, on other hand, often serve larger areas than SMATV service, but offer fewer channels and require line-of-sight for reception.

122. The two principal DBS services are presumed to be technically available nationwide, although they may not actually be available to subscribers in MDUs or in households that are not within the line-of-sight of a DBS signal.[429] The SHVIA, which was enacted in 1999, eliminated the prohibition on DBS delivery of local network signals into their local television markets. Since then, DBS operators have responded by offering local-into-local service in many areas. For example, DirecTV states that it currently offers local broadcast channels in 41 markets.[430] The number of markets with local-to-local service provided by DirecTV is expected to increase after the launch of its new spot beam satellite.[431] NCTA notes that this launch together with changes in the DBS operators' sports programming line-up and the ability to offer Internet service are likely to make DBS an even more viable as a competitor to

[425] *See* Hughes, *GM's Hughes Electronics to Merge with EchoStar Communications* (press release), Oct. 28, 2001, at http://www.hughes.com/ir/pr.

[426] *See* n. 186 *supra.*

[427] We note that for several reasons cable rates have risen faster than inflation. *See* ¶ 9 *supra.*

[428] In November 2000, the Commission concluded that MVDDS can operate in the 12.2-12.7 GHz band on a non-harmful interference basis with the incumbent broadcasting satellite service and on a co-primary basis with the non-geostationary satellite orbit fixed satellite service providers. MVDDS could be used to deliver a wide array of video programming, including local television, and data services in both urban and rural areas. The Commission is seeking comments on technical and service rules for licensing the MVDDS. *See New Fixed Satellite Services Order*, n. 227 *supra.*

[429] In addition, consumers in Alaska and Hawaii may not always receive the same service as those in the 48 contiguous states. For example, Hawaii contends that DBS providers have failed to provide full and competitive service equivalent to that provided on the U.S. mainland. *See* Hawaii Comments at 2-3.

[430] DirecTV Comments at 12.

[431] *Id.* at 2.

cable.[432] DirecTV claims that about half of its subscribers were cable subscribers at the time they first subscribed to DirecTV, with a majority of those eventually canceling their basic cable service.[433]

123. As of June 2001, RCN, which operates a large number of overbuild systems, was offering video service to approximately 460,400 subscribers.[434] In May 2001, SBC reached an agreement to sell its cable subsidiary Ameritech to a startup WideOpenWest.[435] At the time of this transaction, Ameritech was the second largest overbuilder with 310,000 subscribers. Ameritech's departure from the overbuild scene was not an isolated case. Carolina Broadband comments that the number of facilities-based providers have decreased in the past six months. For example, McLeodUSA, WideOpenWest, Utilicom, Seren, Carolina Broadband, American Broadband, and Digital Access have either stopped building new facilities or postponed plans for expansion.[436] However, NCTA contends that several broadband overbuilders and utilities, including RCN, Knology, WideOpenWest, Digital Access, Carolina Broadband, Everest Connection, and Grande Communications, have been able to raise billions of dollars for system development.[437]

124. ***Recent Developments in the MDU Market.*** The MDU market is a significant segment of many local MVPD markets. MDUs are comprised of a wide variety of high-density residential complexes, including high and low-rise rental buildings, condominiums, and cooperatives.[438] According to one estimate, there are currently 21.4 million MDUs in the U.S. That number is expected to grow to 23.3 million by the year 2005.[439] Historically, cable and SMATV operators were the primary providers of MVPD services to MDU residents. According to one estimate, 20-23 percent of a cable operator's income comes from MDU subscribers.[440] More recently, however, DBS providers have begun to supply programming to operators that serve MDUs and to MDU residents directly.[441] In May 2000, WSNet of Austin, Texas, announced the launch of a new satellite video service designed for private cable and small and rural cable companies. Unlike DBS, WSNet provides over 190 digital channels only to SMATV and other small cable operators who in turn distribute these programming services to their subscribers.[442]

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[432] NCTA Comments at 6-15; NCTA Reply Comments at 2.

[433] DirecTV Comments at 11.

[434] Paul Kagan Assocs., Inc., *Top Cable System as of July 2001,* Kagan Cable TV Investor, at 12-13.

[435] *See The Private Market,* 2001 Cable Databook, at 170.

[436] Carolina Comment at 12-13.

[437] NCTA Comments at 20-21.

[438] Townhouses and mobile home communities, nursing homes, hospitals, and hotels may also represent consumer segments in some markets.

[439] Jason Marcheck, *MDUs: Broadband's Wealth of Opportunity,* Private & Wireless Broadband, Dec. 2000, at 16.

[440] Larry Kessler, *Good Night, Gorilla Good Morning, Guerilla,* Private and Wireless Broadband, Mar. 2001, at 12.

[441] DirecTV claims that approximately 20% of its subscribers live in places other than single family homes. *See* DirecTV Comments at 12. *See also* ¶ 76 *supra.*

[442] Joel Schofield, *WSNet Launches Nation's Third Digital Satellite Video Service,* Private & Wireless Broadband, May 2000, at 12.

125. During the late 1990s, a number of large SMATV operators, including OpTel, SkyView, and Cable Plus, declared bankruptcy.[443] According to some analysts, these developments have weakened SMATV's stature as a viable competitor to franchised cable operators in the MDU market.[444] Analysts argue that among other factors, digital video as well as high-speed Internet access is essential to a SMATV operator's survival in the MDU market.[445]

126. A number of SMATV operators are offering bundled video, voice, and data services in order to compete more effectively with traditional cable operators in the MDU market. For example, OnePath Networks, MDU Communications, Everest Broadband Networks and RCN, are providing broadband Internet, telephony, and video services to MDU subscribers throughout the country.[446]

127. ***Competitive Issues in the MDU Market.*** Commenters raise a number of issues that they contend adversely affect their ability to serve the MDU market. These include exclusive contracts, access to MDU inside wiring, and the Commission's over-the-air-reception devices ("OTARD") rules.[447]

128. *Exclusive Contracts.* Commenters suggest that exclusive contracts between incumbent MVPDs and MDU owners represent a barrier to entry in the MDU market.[448] According to commenters, exclusive contracts often were entered into before the arrival of alternative MVPDs in the MDU market, and the continued existence of these contracts prevents the MDU owners and/or their tenants from having an opportunity to select among competing providers.

129. Carolina Broadband contends that competitive broadband service providers cannot serve most MDUs because incumbent cable operators have established exclusive agreements with the owners of these MDUs. According to a survey, 80 percent of the MDU units in Charlotte, North Carolina, for example, have committed to long-term agreements with the incumbent cable operator, many of these agreements taking place after Carolina Broadband announced its intent to serve the area.[449] Carolina Broadband contends that its effort to build a high capacity network is threatened by exclusive contracts between incumbent cable operators and MDU owners that exclude the company from serving 30 percent of its target market. It also contends that exclusive contracts are similar to exclusive franchise agreements since both generally drive up new entrant's costs and distort supply and demand relationships.[450]

130. DirecTV argues that MDU residents have limited choices among MVPD providers because exclusive contracts or exclusive "rights of entry" between incumbents and property owners either

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[443] Larry Kessler, *Winning the Battle and the War: What Does It Take?,* Private & Wireless Broadband, July 2000, at 10.

[444] *Id.*

[445] Larry Kessler, *The Piper's Music: When to Play. When to Pay,* Private and Wireless Broadband, Aug./Sept., 2001.

[446] *See Industry News,* Private and Wireless Broadband, Aug./Sept. 2001, at 57 and Feb. 2001 at 45; RCN Comments at 5-6.

[447] Carolina Comments at 8-9; DirecTV Comments at 18-19; RCN Comments at 21; Utilicorp Comments at 7-8;

[448] *Id.*

[449] Carolina Comments at 7.

[450] Carolina, *ex parte* letter, *Telecommunications Services, Inside Wiring, Customer Premises Equipment,* CS 95-184 and WT 99-127, May 15, 2001.

discourage new entrants or make it impossible for them to enter the market.[451] DirecTV argues that cable operators are able to thwart competition in the MDU market by resorting to exclusive service contracts or exclusive rights to entry that prohibit MDU property owners or residents from obtaining video programming services from an alternative service provider.[452]

131. The Independent Multi-Family Communications Council ("IMCC"), on the other hand, contends that under some circumstances exclusive contracts give MDU residents bargaining power to collectively negotiate with several competing MVPDs for a favorable deal in pricing and service.[453] Moreover, citing a study it commissioned, IMCC argues that there is little risk of competitive harm arising from the use of exclusive contracts by SMATV operators.[454] According to IMCC, since the economies of scale associated with SMATV distribution technology are very low, use of exclusive contracts by SMATV operators would not give them a cost advantage over their rivals that would lead to reduced competition and supra-normal profits.[455]

132. Cablevision states that it faces significant and sometimes unfair competition from SMATV operators in the MDU market. According to Cablevision, since SMATV operators traditionally share revenues with building owners, the latter often enter into agreements with SMATV operators to offer SMATV service to building residents either at "below market rates" or "free" as part of the occupants' rent. Moreover, for buildings under construction, sometimes the SMATV facilities are constructed at the same time, allowing SMATV operators to sign up customers before Cablevision is able to offer service.[456]

133. *Inside Wiring.* RCN contends that access to MDUs remains a serious barrier to entry. More specifically, RCN argues that the Commission's inside wiring rules are of limited value because an incumbent could avoid them by claiming ownership or right to control.[457] RCN further asserts that delayed Commission decisions regarding access to existing inside cable wiring have thwarted its entry into this market.[458]

134. Carolina Broadband argues that rules allowing equal access to home run wiring must be developed so that consumers can choose among competing providers without imposing unreasonable requirements on property owners.[459] IMCC argues that the Commission could encourage competition in MDU markets by determining value of inside wiring based on depreciated book value of the wire and not

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[451] DirecTV Comments at 19.

[452] *Id.*

[453] IMCC, *ex parte* letter, *Telecommunications Services, Inside Wiring, Customer Premises Equipment,* CS 95-184 and *Implementation of the Cable Television Consumer Protection and Competition Act of 1992, Cable Home Wiring,* MM 92-260, May 8, 2001.

[454] *Id.*

[455] *Id.*

[456] Cablevision Reply Comments at 2-3.

[457] RCN Comments at 21.

[458] *Id.*

[459] Carolina Comments at 8.

on replacement costs.[460] Since the replacement cost is generally higher than depreciated book value, IMCC argues that a purchase price based on replacement cost would discourage new entrants from entering the MDU market.[461]

135. On October 12, 2000, the Commission adopted measures to enhance the ability of competing telecommunications providers to provide services to customers in residential and commercial buildings or other MTEs.[462] The adopted measures included a determination that utilities, including LECs, must afford telecommunications carriers and cable service providers reasonable and nondiscriminatory access to conduits and rights-of-way located in customer buildings and campuses, to the extent such conduits and rights-of-way are owned or controlled by the utility. The Commission also sought additional comments on whether it should extend its cable inside wiring rules to facilitate the use of home run wiring by telecommunications service providers where an incumbent cable provider no longer has a legal right to maintain its home run wiring in the building.

136. *OTARD Rules.* DirecTV asserts that the Commission's OTARD rules should be expanded to cover common areas for MDU residents.[463] On November 20, 1998, the Commission extended the OTARD rules to allow renters to install antennas within their "exclusive use" areas, i.e., apartments, homes, gardens, patios, terraces, and balconies. The rules, however, do not extend to the installation of antennas on common property or on property to which a viewer does not have a right of access.[464] DirecTV states that while the Commission's OTARD rules have encouraged some MDU landlords and owners to use a single dish for reception to prevent "dish clutter," the rule should be

[460] IMCC, *ex parte* letter, *Telecommunications Services, Inside Wiring, Customer Premises Equipment,* CS 95-184 and *Implementation of the Cable Television Consumer Protection and Competition Act of 1992, Cable Home Wiring,* MM 92-260, May 8, 2001. The Commission in a *Report and Order and Second Further Notice of Proposed Rulemaking,* amended the cable inside wiring rules to enhance competition in the video distribution market. *See Inside Wiring Order*, n. 273 *supra.*

[461] IMCC, *ex parte* letter, *Telecommunications Services, Inside Wiring, Customer Premises Equipment,* CS 95-184 and *Implementation of the Cable Television Consumer Protection and Competition Act of 1992, Cable Home Wiring,* MM 92-260, May 8, 2001.

[462] *Promotion of Competitive Networks in Local Telecommunications Markets, Wireless Communications Association International, Inc. Petition for Rulemaking to Amend Section 1.4000 of the Commission's Rules to Preempt Restrictions on Subscriber Premises Reception or Transmission Antennas Designed to Provide Fixed Wireless Service, Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Review of Sections 68.104 and 68.213 of the Commission's Rules Concerning Connection of Simple Inside Wiring to the Telephone Network,* WT Docket No. 99-217, CC Docket No. 96-98, CC Docket No. 88-57, First Report and Order and Further Notice of Proposed Rulemaking in WT Docket No. 99-217, Fifth Report and Order and Memorandum Opinion and Order in CC Docket No. 96-98, and Fourth Report and Order and Memorandum Opinion and Order in CC Docket No. 88-57. 15 FCC Rcd 17521 (2000).

[463] DirecTV Comments at 19.

[464] *Restrictions on Over-the-Air Reception Devices: Television Broadcast, Multichannel Multipoint Distribution and Direct Broadcast Satellite Services*, CS Docket No. 96-83, Second Report and Order, 13 FCC Rcd 23874 (1998); *see also Restrictions on Over-the-Air Reception Devices: Television Broadcast, Multichannel Multipoint Distribution and Direct Broadcast Satellite Services*, CS Docket No. 96-83, Order on Reconsideration, 14 FCC Rcd 19924 (1999).

extended to common areas so that renters and owners who do not have exclusive use of areas suitable for satellite reception will also be able to receive DBS service.[465]

2. Competitive Issues in the Market for the Purchase of Video Programming

137. Buyers in the market for the purchase of video programming are MVPDs, including cable operators and other video programming providers, and the sellers are primarily non-broadcast programming networks.[466] This market tends to be regional or national since programmers seek to reach a much broader audience than could be provided by a local cable franchise area. For example, some programming services are intended for a nationwide audience (e.g., CNN, USA) while others seek a regional audience (e.g., New England Sports Channel).

138. AT&T argues that the Commission should include purchasers of all video programming, and not just multichannel video programming, when considering the market for the purchase of video programming.[467] AT&T argues that broadcast stations and networks compete with MVPDs in the program purchase market as well as in the advertising and program distribution markets. The Commission has recognized AT&T's concern and is addressing this issue in its recently released *Further Notice of Proposed Rulemaking* ("*Ownership Further Notice*").[468] In that proceeding, the Commission contemplated that over-the-air broadcast networks compete with MVPDs for advertising revenue, and also observed that they are carried as content on MVPD systems. The Commission also sought comments on its portrayal of the program purchase market in that further notice.[469]

a. The Regional Market

139. For the past several years, cable operators have engaged in a regional strategy called "clustering." Many of the largest MSOs have concentrated their operations by acquiring cable systems in regions where the MSO already has a significant presence, while giving up smaller holdings scattered across the country. This strategy is accomplished through purchases and sales of cable systems, or by system "swapping" among MSOs.

140. ***Competitive Issues Related to Clustering***. Commenters contend that clustering of cable systems can create greater economies of scale and scope, and enable cable operators to offer a wider variety of broadband services at lower prices to customers. In addition, commenters contend that clustering enables cable operators to: (a) spread costs over a number of systems and a larger subscriber base; (b) deliver a higher quality of signal to consumers; (c) offer more local and regional programming

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[465] DirecTV Comments at 19.

[466] *1998 Report*, 13 FCC Rcd at 24362.

[467] AT&T Comments at 20.

[468] *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, Review of the Commission's Regulations Governing Attribution of Broadcast and Cable/MDS Interests, Review of the Commission's Regulations and Policies Affecting Investment in the Broadcast Industry, Reexamination of the Commission's Cross-Interest Policy*, CS Docket Nos. 98-82, 96-85, MM Docket Nos. 92-264, 94-150, 92-51 and 87-154, Further Notice of Proposed Rulemaking, 16 FCC Rcd 17312 (2001).

[469] *Id.*, 16 FCC Rcd at 17321-2.

for consumers; (d) provide better customer service and fewer outages; (e) create more efficient interconnections which enhance educational and governmental uses; (f) develop more attractive joint consumer promotions and discounts with area retailers and others; and (g) increase advertising revenues which can, in turn, be used to offset a portion of programming and system upgrade expenses.[470]

141. In the *2000 Price Survey Report*, using a regression equation, the Commission reported that cable operators that were part of a cluster had, on average, higher monthly rates than operators that were not part of a cluster (i.e., a positive relationship was found to exist between average monthly rates and clusters).[471] This result may have been due to a lack of data needed to: (a) distinguish between integrated and non-integrated systems, and (b) identify cost factors or the timing of consolidation. AT&T contends that, when it applied the Commission's regression equation to its own 2000 survey data (which represents a small percentage of the total data used in the *2000 Price Survey Report*), the results indicate that a negative relationship exists between clustering and cable prices.[472]

142. Several commenters assert harmful effects of clustering and regional concentration on program distribution.[473] Specifically, these commenters contend that it is likely that cable systems in a large cluster will be linked through a fiber optic network which would enable operators to offer telecommunications services as well as a cost-efficient means of delivering programming to its clustered systems. However, if MSOs have an ownership interest in programming, fiber optic networks may give them an added incentive to "migrate" programming from satellite delivery to terrestrial (fiber optic) delivery because only satellite-delivered programming is subject to the program access rules. Therefore, these commenters contend that a vertically integrated incumbent may be able to prevent competitors from gaining access to certain programming because it is terrestrially delivered.[474]

143. ***Recent Developments in Clustering***. Since the previous report, cable MSOs have continued to undertake or announce system mergers, acquisitions, divestitures, swaps, and joint ventures in order to create larger regional clusters of contiguous cable systems.[475] Most of these transactions resulted in the expansion of existing regional clusters. For example, Comcast's "Mid-Atlantic Super Cluster" with 4.4 million subscribers includes clusters in Pennsylvania, Maryland, Virginia, the Washington, D.C., metropolitan area, and Delaware.[476] Similarly, AT&T has large clusters in the Chicago, San Francisco/Oakland/San Jose, and Boston areas, with approximately five million subscribers in those three clusters.[477]

[470] AT&T Comments at 17-18; Comcast Comments at 12-13.

[471] *Id. Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992, Statistical Report on Average Rates for Basic Service, Cable Programming Services, and Equipment*, MM Docket No. 92-266, Report on Cable Industry Prices (*"2000 Price Survey Report"*), 16 FCC Rcd 4346 (2001).

[472] AT&T Comments at 19-20.

[473] EchoStar Comments at 6-7; WCA Comments at 2-3; DirecTV Comments at 9-10; RCA Comments at 25.

[474] *Id.*

[475] App. B, Tbl. B-7.

[476] Comcast Comment at 11. *Major Cable TV Systems/Clusters*, 2001 Cable Databook, at 36.

[477] *Major Cable TV Systems/Clusters*, 2001 Cable Databook, at 36.

144. Between July 2000 and June 2001, a total of 48 transactions were announced having an aggregate value of approximately $22.5 billion and involving 5.8 million subscribers, virtually all intended to increase the size of existing cable clusters.[478] At the end of 2000, there were 108 clusters with approximately 54 million subscribers compared to 114 clusters and approximately 44 million subscribers at the end of 1999.[479] In the largest cluster size category (over 500,000 subscribers), the number of clusters increased by 21.4 percent between 1999 and 2000, and the number of subscribers in these clusters increased by 44.1 percent.

145. ***System Mergers and Acquisitions***. Several notable mergers and acquisitions occurred during the period from July 2000 to June 2001. In May 2001, WideOpenWest with 200 subscribers agreed to acquire Ameritech and its 310,000 subscribers in Detroit, Chicago, Columbus, and Cleveland.[480] In January 2001, Insight Communications and AT&T completed the transfer of 530,000 subscribers to Insight Midwest JV involving three transactions totaling $1.5 billion. In February 2001, AT&T announced its intention to sell another 1.4 million subscribers to Mediacom and Charter for approximately $4 billion.[481]

146. ***System Trades***. System-for-system "swaps" or trades enable MSOs to increase the size of their regional clusters while minimizing financial outlays and avoiding capital gains taxes.[482] Since our last report, many of the largest proposed swaps, as measured by number of subscribers, involved AT&T, Comcast, and Adelphia. In December 2000, AT&T and Comcast agreed to swap 770,000 subscribers in the Washington, D.C., area and in cities in Pennsylvania, New Jersey, Florida, Michigan, California, and Illinois. In January 2001, Comcast and Adelphia announced a swap of approximately 450,000 subscribers in Philadelphia, Los Angeles, and Palm Beach.[483]

b. The National Market

147. ***Competitive Issues***. Several commenters raise concerns about the anticompetitive effects of horizontal concentration of ownership on the purchase of programming.[484] EchoStar, for example, argues that large cable operators exert market power on programmers enabling cable operators to dominate the programming market and to purchase programming at anti-competitive terms and conditions.[485]

148. Recently, in *Time Warner Entertainment Co. v. FCC* ("*Time Warner*"), the United States Court of Appeals for the D.C. Circuit reviewed the Commission's cable television horizontal and vertical

[478] Paul Kagan Assocs., Inc., *Cable System Sales Summary*, Cable TV Investor, Aug. 11, 2000, at 9; Feb. 5, 2001, at 12; and Aug. 29, 2001, at 9.

[479] *See* App. C, Tbl. C-2.

[480] Paul Kagan Assocs., Inc., *SBC Finally Offloads Ameritech Subs,* Cable TV Investor, May 24, 2001, at 6.

[481] Paul Kagan Assocs., Inc., *AT&T Sheds Subs, Mediacom Doubles Its Size,* Cable TV Investor, Mar. 2, 2001, at 4.

[482] *1997 Report*, 13 FCC Rcd at 1118-19.

[483] Paul Kagan Assocs., Inc., *Pending Swaps Finally Close*, Cable TV Investor, Feb. 5, 2001, at 8.

[484] EchoStar Comments at 5; WCA Comments at 3-4; RCN Reply Comments at 3.

[485] EchoStar Comments at 5.

ownership limits and attribution benchmarks.[486] In *Time Warner*, the D.C. Circuit found that the Commission's horizontal rules restrict cable operators' ability to reach viewers and that the vertical rules curtail their exercise of editorial control over a portion of their channels. The D.C. Circuit held that the Commission did not establish record evidence to support the limits, did not draw the necessary connection between the limits established and the alleged harms of concentration and integration the limits were designed to address, and did not take into account the changing industry market conditions. The D.C. Circuit thus remanded both the horizontal and vertical limits to the Commission for further consideration.[487]

149. On September 13, 2001, the Commission adopted the *Ownership Further Notice* seeking to implement Section 613(f) and to respond to the D.C. Circuit's concerns, by taking a fresh look at the Commission's cable ownership rules affected by the *Time Warner* decision.[488] The *Ownership Further Notice* examines the requirements of Section 613(f) and the underlying legislative history, reviews the relevant markets, as those markets existed in and have evolved since 1992, and considers general regulatory approaches. The *Ownership Further Notice* asks commenters to support or contradict alternative approaches with empirical or theoretical evidence, as well as address the benefits and harms posed by each approach. The objective of the Further Notice is to develop a complete record that ultimately will support a regulatory approach, which fully addresses and takes into account cable operators' market power in today's dynamic communications marketplace.

150. ***Concentration in the National Market for the Purchase of Video Programming.*** Over the past year, cable operators continue to be the primary purchasers in the national market for the purchase of multichannel video programming. Cable operators controlled 78.06 percent of the total MVPD subscribers.[489] At the same time, non-cable MVPDs continued to increase their share of the MVPD market which translates into increased program purchasing in that market. For example, DirecTV's share of the MVPD market increased from 10.28 percent in 2000 to 11.38 percent in 2001. Similarly, EchoStar's share increased from 5.11 percent in 2000 to 6.87 percent in 2001.[490]

151. The top four purchasers of video programming for distribution to the household or MDU market are AT&T (with a share of 16.43 percent of all MVPD subscribers), Time Warner (with a share of 14.34 percent), DirecTV (with a share of 11.38 percent), and Comcast (with a share of 9.53 percent).[491] It should be noted that these percentages are derived from publicly available data and are not the result of application of the Commission's attribution rules.[492] For example, AT&T in a recent letter to the

[486] 240 F.3d 1126 (D.C. Cir. 2001).

[487] *Id.* at 1128, 1130.

[488] *Ownership Further Notice*, 16 FCC Rcd at 17315-9.

[489] *See* App. C, Tbl. C-1.

[490] DirecTV is the third largest MVPD with 8.7 million subscribers; EchoStar is the eighth largest MVPD with 4.3 million subscribers. *See* App. C, Tbl. C-3.

[491] On December 19, 2001, AT&T and Comcast announced an agreement to combine their cable companies to create a new company, AT&T Comcast Corporation. *See AT&T Broadband to Merge With Comcast in $72 Billion Transaction* (press release), Dec. 19, 2001.

[492] For Commission's attribution rules, *see Implementation of the Cable Television Consumer Protection and Competition Act of 1992, Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996:*

(continued....)

Commission states that it has 21,979,500 MVPD subscribers based on the Commission's attribution rules.[493]

152. The share of subscribers of these top four MVPDs has declined slightly over the past year. In 2000, the four MVPDs with the largest subscribership served 52.70 percent of all MVPD subscribers.[494] In 2001, the top four MVPDs served 51.68 percent of all MVPD subscribers nationwide.[495] However, the share of subscribers served by the top ten MVPDs increased slightly from 83.90 percent in 2000 to 84.30 percent in 2001.

153. To compare and assess the potential for market power resulting from concentration in the market for the purchase of programming over a period of time, we employ the Herfindahl-Hirschman Index ("HHI").[496] We use the reported MVPD shares to calculate HHI figures.[497] The nationwide purchaser MVPD HHI is 905 – considered "unconcentrated" under the Merger Guidelines.[498] Since, the larger firms in the calculation are more equal in size, the HHI for 2001 is 49 points lower than the HHI of 954 reported last year.[499]

154. Economist Incorporated ("Economists, Inc."), in a study commissioned by NCTA, contends that the Commission places undue emphasis on "purely structural indicia" of market power, i.e., market share, which leads to misleading results.[500] According to Economist Inc., a firm with a large market share will not be able to exercise market power and raise prices above competitive levels if the

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Review of the Commission's Attribution Rules, Report and Order, CS Docket Nos. 98-82, 96-85, 14 FCC Rcd 19014 (1999).

[493] AT&T, *ex parte* letter, MM Docket No. 92-264 and CS Docket No. 99-251, Oct. 22, 2001.

[494] *1998 Report*, 13 FCC Rcd at 24422.

[495] *See* App. C, Tbls. C-3 and C-4.

[496] *1998 Report*, 13 FCC Rcd at 24363. The HHI is a measure of concentration that is calculated by summing the squared market shares of the sellers in the market. It is a measure of concentration that takes account of the entire firm size distribution. The HHI varies with the number of firms in the market and degree of inequality among firm size. Generally, the HHI increases when there are fewer and unequal sized firms in the market. If the firms in the market are similar in size or if there is only one firm, the HHI has no advantage over other measures of concentration such as four-firm or eight-firm concentration ratio. Thus, in local video distribution markets where the incumbent cable operator is the only MVPD, the HHI is of limited use. However, in the market for the purchase of video programming, where both cable and non-cable MVPDs compete, the HHI is sensitive to differences in firm size. In addition, a comparison of HHIs from previous years would show a general trend in ownership concentration.

[497] Since MVPDs generally purchase programming on a "per subscriber" basis, the total license fee paid for a program is based, in part, on the total number of subscribers served by the MVPD. As the subscribership increases, so does the total license fee paid by the MVPD.

[498] The United States Department of Justice and Federal Trade Commission consider markets with HHI below 1000 as "unconcentrated;" markets with an HHI between 1000 and 1800 as "moderately concentrated;" and markets with HHI above 1800 as "highly concentrated." *See 1998 Report*, 13 FCC Rcd at 24363.

[499] *1998 Report*, 13 FCC Rcd at 24422.

[500] Economist Incorporated, *Use and Limitations of Structural Indicia of Market Power*, Aug. 6, 1999, NCTA Comments at App. C.

smaller competing firms are able to quickly increase their outputs and sales so that the price increase becomes unprofitable for the large firm. Economist Inc. further contends that, since DBS is available nationwide and has virtually unlimited capacity to expand to a larger number of customers, it has the ability to constrain or eliminate market power of larger cable MSOs.[501] The *Ownership Further Notice* seeks comment on whether DBS can in fact provide a constraint on cable's market power in the market for the purchase of programming. The further notice also seeks comment on whether DBS can provide a constraint on cable's market power in the markets for the delivery of programming.[502]

155. To summarize, our examination of national MVPD concentration currently reveals that the national market for the purchase of video programming by MSOs is less concentrated than the local markets in which the distribution of video programming to consumers takes place, which remains highly concentrated. In the regional and national markets for the purchase of video programming, a number of large MSOs are consolidating their subscriber base, although the share of the two largest MSOs (AT&T and Time Warner) has declined during the past year.[503] For example, AT&T's share of MVPD subscribers fell from 19.07 percent in 2000 to 16.43 percent in 2001. Time Warner's share changed slightly from 14.92 percent in 2000 to 14.34 percent in 2001.[504]

B. Vertical Integration and Other Programming Issues

1. Status of Vertical Integration

156. This section updates the status of vertically integrated video programming networks in the MVPD market. Vertical integration occurs where a video programming distributor has an ownership interest in a video programming supplier or vice versa. These vertical relationships may have beneficial effects,[505] or they may deter competitive entry in the video marketplace and/or limit the diversity of programming.[506]

157. Since our last *Report*, the total number of programming networks has grown and cable operators continue to consolidate and develop new ownership interests. This year, the proportion of vertically integrated channels is the same as last year, after several years of decline. In 2001, there were 294 satellite-delivered national programming networks, an increase of 13 networks since 2000. Of the 294 networks, 104 networks, representing approximately 35 percent, were vertically integrated with at

[501] *Id.* at 10.

[502] *Ownership Further Notice*, 16 FCC Rcd at 17330.

[503] *See* App. C, Tbl. C-3.

[504] By squaring market shares, the HHI weighs the values for large companies more heavily than small companies. Also, the HHI increases with increasing inequality among any given number of companies. *See* F.M. Scherer, *Industrial Market Structure and Economic Performance*, Rand McNally College Publishing Company, 1980, at 58.

[505] Beneficial effects can include efficiencies 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, e.g.*, H.R. Rep. No. 862, 102nd Cong., 2d Sess. 56 at 41-43 (1992).

[506] *See 1995 Report*, 11 FCC Rcd at 2135; *Implementation of Section 11(c) of the Cable Television Consumer Protection and Competition Act of 1992 Vertical Ownership Limits*, MM Docket 92-264, Memorandum Opinion and Order on Reconsideration of the Second Report and Order, 10 FCC Rcd 7364, 7365 (1995).

least one cable MSO.[507] Therefore, the ratio of vertically integrated channels has remained unchanged since 2000 when 99 of 281, or 35 percent, of national programming networks were vertically integrated.[508]

158. Four of the top seven cable MSOs hold ownership interests in satellite-delivered national programming networks. One or more of these companies has an interest in 52 of the 104 vertically integrated national satellite-delivered programming networks.[509] These four companies are Cox Communications, which has interests in 24, or eight percent of all national programming networks; AOL Time Warner, which has an ownership interest in 39, or 13 percent of all national programming networks; Comcast, which has ownership interests in 17 networks, which account for six percent of all national programming networks; and Cablevision, through its programming subsidiary, Rainbow Media, which owns ten national programming networks, just over three percent of all national programming networks. On August 10, 2001, Liberty Media split off from AT&T Corporation and is now an independent company.[510] However, through its ownership of Cablevision of Puerto Rico, it remains a small cable system owner. It has interests in 66 national networks, or 23 percent of all programming networks.[511]

159. Vertical integration is not only associated with the largest cable system operators, but also the programming networks with the largest number of subscribers. Currently, nine of the top 20 video programming networks (ranked by subscribership) are vertically integrated with a cable MSO. This figure remains unchanged from 2000.[512] Additionally, it appears that a significant amount of video programming is controlled by only 14 companies, including cable MSOs, broadcasters, and other media entities.[513] Almost all (i.e., 18) of the top 20 programming networks in terms of subscribership are owned by one or more of these 14 companies, with nine of these networks vertically integrated with cable MSOs.[514] In addition, seven out of the top 20 video programming networks ranked by prime time ratings are vertically integrated with cable MSOs.[515]

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[507] We count each unique programming service of a multiplexed package separately. We do not, however, count services that are not unique, as in a multiplexed programming service that is merely time shifted. *See 1998 Report*, 13 FCC Rcd at 24376. *See also 2000 Report*, 16 FCC Rcd at 6079.

[508] These figures are based on the best available information recently researched for the 2001 Report and differ from a recently reported figure which was estimated based on data from the *2000 Report*. *See Ownership Further Notice*, 16 FCC Rcd at 17350.

[509] The top seven MSOs are AT&T Broadband & Internet Services, AOL Time Warner, Comcast Cable Communications, Charter Communications, Cox Communications, Adelphia Communications, and Cablevision Systems. *See* NCTA, *Industry Overview*, Cable Television Developments 2001, at 17.

[510] Liberty Media Corp., *Liberty Media Corporation Announces Split Off From AT&T Corp.; Begins Trading on New York Stock Exchange Under the Symbols LMC.A and LMC.B* (press release), Aug. 10, 2001.

[511] If we did not count Liberty Media as being vertically integrated, the ratio of vertically integrated channels would decrease from 35 percent in 2000 to 31 percent in 2001. *See* App. D., Tbl. D-5.

[512] App. D, Tbl. D-6. *See also 2000 Report*, 16 FCC Rcd at 6138.

[513] The 14 companies are: AOL Time Warner, Cablevision, Comcast, Cox, Disney, E. W. Scripps Co., General Electric, Hearst, Liberty Media, MGM, Newhouse, News Corp., Viacom, and Vivendi. *See* Paul Kagan Assocs., *Major Owners of Cable Networks: Sept. 2001*, Cable Program Investor, Sept. 11, 2001, at 4.

[514] C-SPAN, C-SPAN2, WGN, and The Weather Channel are the four unaffiliated programming networks among the top 50 programming networks. Cable affiliates provide 95 percent of the funding for, but have no ownership or program control interests in C-SPAN and C-SPAN2. DBS licensees provide the other 5 percent of funding, and also have no ownership or program control interests. None of the 14 companies listed in footnote 513 *supra* have any (continued....)

160. This year we found 51 programming services that have been planned but are not yet operational, a 23 percent decrease from the *2000 Report*'s count of 66 planned services.[516] As we reported last year, analog channel capacity is increasingly scarce and may account for the slow down in the launching of new programming networks.[517] The planned services count includes some overlap from previous years because it can often take several years from the announcement of a new programming network to its launch and initiation of service. For example, several of the 66 planned services counted in previous *Reports* have been launched during the past year and are now operating, while others have been aborted for various reasons.[518]

2. Other Programming Issues

161. As in previous years, this year's *Notice* requested comment on a number of programming issues apart from vertical integration and the status of existing and planned programming services. Among these issues, we asked about the effectiveness of our program access, program carriage, and channel occupancy rules that govern the relationships between cable operators and programming providers. We also requested information about local and regional channels, including sports and news services, public, educational and governmental ("PEG") access channels, packaging of programming services, and electronic programming guides ("EPGs"). In this section we address these issues.

162. ***Regulatory Issues Relating to Program Access and Carriage Rules.*** The Commission's rules on competitive access to cable programming prohibit unfair and discriminatory practices by vertically integrated cable operators.[519] The rules seek to promote competition and diversity in the multichannel video programming market by preventing vertically integrated programming suppliers from favoring affiliated video distributors over unaffiliated MVPDs in the sale of satellite-delivered programming.[520] The program access rules apply to cable operators and to programming vendors that are affiliated with cable operators and deliver video programming via satellite to an MVPD. The rules prohibit any cable operator that has an attributable interest in a satellite cable programming vendor from improperly influencing the decisions of the vendor with respect to the sale or delivery, including prices, terms, and conditions of sale or delivery, of satellite-delivered programming to any competing MVPD. The rules also prohibit vertically integrated satellite programming distributors from discriminating in the prices or terms and conditions of sale of satellite-delivered programming to cable operators and other MVPDs. In addition, cable operators generally are prohibited from entering into exclusive distribution

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ownership interest in WGN or The Weather Channel. *See* Paul Kagan Assocs. *Network Census: July 30,* Cable Program Investor, Sept. 11, 2001, at 10.

[515] App. D, Tbl. D-7.

[516] *See* App. D, Tbl. D-4. *See also 1999 Report,* 15 FCC Rcd at 1112.

[517] *2000 Report,* 16 FCC Rcd at 6080. *See also* Andy Grossman, *High Stakes in Vegas, Court TV's Royal Analog Flush,* Cablevision, July 9, 2001, at 8.

[518] Compare, for example, App. D, Tbl. D-4 *infra,* with *2000 Report,* 16 FCC Rcd at 6131, *1999 Report,* 15 FCC Rcd at 1112, and *1998 Report,* 13 FCC Rcd at 24442.

[519] 47 C.F.R. §§ 76.1000-76.1003. *See also* 47 U.S.C. § 536(a)(2); 47 U.S.C. § 548(a)(2). The program access rules apply to OVS operators and common carriers in the same manner as they apply to cable operators. 47 C.F.R. §§ 76.1004, 76.1507.

[520] 47 U.S.C. § 548.

arrangements with vertically integrated programming vendors. The Commission has declined to apply the program access requirements to terrestrially-delivered programming.[521]

163. The prohibition on exclusive contracts in the program access law ceases to be effective on October 5, 2002, unless the Commission finds that the prohibition continues to be necessary to preserve and protect competition and diversity in the distribution of video programming.[522] On October 11, 2001, the Commission adopted a *Notice of Proposed Rule Making* to begin its review of the rule.[523] In the *Notice* in this proceeding, we sought comment on the methods we should use to evaluate whether this provision still is needed, and on other issues related to the availability of vertically integrated programming.[524]

164. Cable's competitors, including SBCA, Utilicorp, and WCA, are opposed to the sunset of the prohibition on exclusivity and some suggest that the program access rules should be broadened to include terrestrially-delivered programming.[525] Several commenters maintain that, despite the presence of the program access rules, lack of access to programming, especially sports programming, remains a significant barrier to entry and an impediment to the successful development of a competitive MVPD business.[526] In particular, WCA maintains that the cable industry's conduct suggests that the programming most in demand will become unavailable if the ban on exclusivity is relaxed.[527]

165. DirecTV asserts that the program access rules are more important now than ever and that the Commission should make them even more stringent.[528] It urges the Commission to examine the October 5, 2002, sunset on the prohibition on exclusive contracts in the program access rules in light of technical advances that have diminished the costs of terrestrial delivery and in light of continued cable clustering which facilitates terrestrial delivery.[529]

166. Cable television operators oppose the extension of the program access rules. NCTA disputes WCA's assertions and points to the success and continued growth of DBS and the increase in competition over the past five years to demonstrate that the program access rules exclusivity provisions have served their purpose and should be allowed to sunset.[530] NCTA asserts that the current MVPD landscape is competitive and surpasses anything that Congress or the Commission could have imagined in 1992. NCTA also opposes any expansion to the scope of the current rules and dismisses concerns related

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[521] *Implementation of the Cable Television Consumer Protection and Competition Act of 1992, Petition for Rulemaking of Ameritech New Media, Inc. Regarding Development of Competition and Diversity in Video Programming Distribution and Carriage*, CS Docket No. 97-248, RM No. 9097, Report and Order ("*Program Access Order*"), 13 FCC Rcd 15822, 15856-7 (1998).

[522] 47 U.S.C. § 548(c)(5).

[523] *See Program Access NPRM*, n. 213 *supra*.

[524] *Notice*, 16 FCC Rcd at 13333, 13346.

[525] SBCA Comments at 9; Utilicorp Comments at 8; WCA Comments at 4-8.

[526] Carolina Comments at 12; EchoStar Comments at 11-12; RCN Comments at 9-13; SBCA Comments at 9.

[527] WCA Comments at 5.

[528] *Id.* at 9-10.

[529] DirecTV Comments at 10

[530] NCTA Comments at 39.

to the "terrestrial migration" of channels from satellite delivery to terrestrial delivery.[531] NCTA points out that DBS has had exclusive rights to some major league sports packages, concerts, and other programming. It likens these contracts to the development of cable exclusive terrestrially-delivered programming.[532]

167. Cablevision states that there is a wide variety of programming available and that the program access rules are no longer necessary.[533] Comcast asserts that the program exclusivity rules pertain to marketplace conditions that no longer exist. It argues that exclusive contracts are commonplace in the communications industry, and that such arrangements spur investment, creativity, and responsiveness to consumer demand.[534]

168. Comcast also suggests criteria for the Commission to apply in its proceeding to evaluate the program access rules. These criteria are: (a) the marketplace benefits of permitting program exclusivity for satellite-delivered programming in which a cable operator has a financial interest; (b) the evolution of the MVPD marketplace since 1992; (c) the extent to which exclusive agreements have been used successfully by large non-cable MVPDs; (d) the lack of any basis for constraining exclusivity in cable contracts for satellite-delivered cable programming while not constraining exclusivity in DBS contracts; (e) whether sufficient alternative programming networks exist to provide competition if certain satellite-delivered networks enter into exclusivity agreements; and (f) whether the Commission would have the tools to prevent discrimination, unfair methods of competition, or other unfair acts by vertically integrated satellite programming networks against competing MVPDs.[535] RCN suggests that the Commission form an industry forum among MVPDs, programming providers, and other interested parties to create an interactive dialogue to evaluate program access issues.[536]

169. In 1998, in the *Program Access Order*, the Commission found "no indications at this time that terrestrial delivery of programming formerly delivered by satellite is a significant competitive problem."[537] Several commenters now assert that access to popular programming, including terrestrially-delivered programming, is vital and more important than ever.[538] Carolina recommends that the Commission expand the program access rules to encompass any method of delivery. Moreover, it suggests that the rules should cover content delivered from all platforms, such as the Internet, interactive program guides, VOD, and ITV.[539]

170. Pursuant to section 613(f) of the Communications Act,[540] the Commission also adopted channel occupancy rules that restricted the number of channels on a cable system that may be occupied by

[531] *Id.*

[532] NCTA Comments at 38-39.

[533] Cablevision Reply Comments at 7.

[534] Comcast Reply Comments at 17-18.

[535] *Id.* at 21.

[536] RCN Comments at 14-15.

[537] *Program Access Order*, 13 FCC Rcd at 15856-7.

[538] Carolina Comments at 11; DirecTV Comments at 9; RCN Comments at 14.

[539] Carolina Comments at 11.

[540] Section 613(f) was added to the Communications Act as part of the 1992 Cable Act. 47 U.S.C. § 533(f).

programmers affiliated with the owner of the system.[541] On March 3, 2001, the United States Court of Appeals for the D.C. Circuit reversed and remanded Commission's channel occupancy limits.[542] Currently, the Commission is seeking comment on, among other things, how changes in the MVPD market and in the level of vertical integration for cable MVPDs may have affected MSOs' ability to favor affiliated over unaffiliated programming.[543] Given the changes in the marketplace, in the *Ownership Further Notice*, the Commission requests comment on how to fashion meaningful and relevant channel occupancy limits.

171. ***Sports Programming***. Regional sports programming continues to be an important segment of programming for all MVPDs. According to RCN, sports programming is critical to the success of any cable television system.[544] Of the 80 regional cable channels counted in this year's report, 29, or 36 percent, are sports channels.[545]

172. The most widely distributed sports programming network, ESPN, which is owned by Disney, reaches 81 million television households through a variety of delivery technologies. While ESPN dominates national sports programming, regional sports distribution is dominated by Fox Sports Net, which owns 69 percent (20 of 29) of all regional sports networks. Fox Sports Net, jointly owned by News Corp. and Cablevision, reaches 77 million television households.[546] Both News Corp. and Disney also have interests in sports teams and sports venues.

173. Commenters assert that such vertical integration, especially with important sports programming, gives these programmers incentives to act as gatekeepers and engage in unfair methods of controlling access to sports programming.[547] Commenters note that vertically integrated entities may have an incentive to shift regional sports networks from satellite to terrestrial distribution and thereby avoid the ambit of program access rules.[548] In addition, commenters allege that where a regional sports network is non-vertically integrated, a video programming distributor may enter into an exclusive contract with the program provider which deprives rivals of the programming.[549] RCN also alleges that clustering has an impact on access to sports programming.[550] In the *1999 Report*, we noted that because most sports programming affiliate fees are based on subscriber volume, only well clustered, large MSOs can take full advantage of programming discounts.[551]

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[541] 47 C.F.R § 76.504. *See 1994 Report,* 9 FCC Rcd at 7521.

[542] *Time Warner Entertainment Co. v. FCC*, 240 F.3d 1126 (D.C. Cir.2001).

[543] *See Ownership Further Notice*, n. 468 *supra.*

[544] RCN Comments at 13.

[545] *See* App. D, Tbl. D-3.

[546] NCTA, *Regional Cable Networks,* Cable Television Developments 2001, at 174 - 200.

[547] RCN Comments at 9-16.

[548] *See* ¶ 162 *supra* for a more detailed description of program access.

[549] Carolina Comments at 10-11; RCN Reply Comments at 4.

[550] RCN Comments at 22-23.

[551] *1999 Report*, 15 FCC Rcd at 1060. *See also* R. Thomas Umstead, *Consolidation Blues*, Cablevision, June 28, 1999, at 39.

174. DirecTV lists 23 regional sports networks (including 17 Fox Sports Networks) that are carried on its system.[552] DirecTV carries regional sports networks in every regional sports market except Philadelphia where it was refused access to Comcast's SportsNet.[553] EchoStar states that exclusivity deals between video programming distributors and sports leagues are "detrimental to subscribers" who cannot get such sports programming from a DBS company.[554] Where a regional sports channel is non-vertically integrated, a cable MSO may enter into an exclusive contract with the program provider. Alternatively, Comcast notes that DirecTV is not required to make its *NFL Sunday Ticket* package available to any other MVPD provider, and that it indeed does not make it available to any Comcast cable system.[555]

175. ***News Programming***. Cable systems have carried local news services since at least 1986, when Cablevision launched News 12 Long Island. This year, of the 80 regional programming networks counted, 36 percent (29 networks) are regional news networks. Unlike sports programming, regional and local news networks have a more diverse ownership. Some regional news networks are vertically integrated with cable MSOs, but many are not.[556]

176. Most regional news networks cover a single city or other limited geographic market, or subsections of that market. There are at least seven local news networks in separate sections of the New York City area.[557] A handful of regional news networks, however, have elected to broaden their coverage. Statewide news channels are operating in Florida, Massachusetts, Texas, and Ohio. New England Cable News ("NECN") is the oldest statewide network and the most widely distributed regional news network. NECN reaches more than 2.5 million households, approximately 64 percent of cable homes in the six-state region it serves. In the Boston market, the network can be seen in 92 percent of cable homes.[558] However, not all regional news networks are success stories. BayTV News Network in San Francisco, California, reached 1.4 million homes with programming that featured local news, high-school sports, and public affairs. However, viewership remained low and it ceased operating on July 31, 2001.[559] Another California news network, Orange County Newschannel, which served 177,000 homes with local news,

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[552] DirecTV Comments at Exhibit A.

[553] *Id. See also Application for Review of Orders of the Cable Services Bureau Denying Program Access Complaints*, CSR 5122-P and CSR 5244-P, Memorandum Opinion and Order, 15 FCC Rcd at 22802 (2000). This Order consolidates several proceedings involving Comcast, DirecTV, and EchoStar. In separate proceedings, DirecTV and EchoStar filed program access complaints alleging that Comcast violated sections 628(b) and (c) of the Communications Act and the Commission's regulations by engaging in discrimination and unfair practices in the distribution of satellite cable programming. The Cable Services Bureau denied the complaints. Subsequently, DirecTV and EchoStar each requested Commission review; the Commission consolidated the proceedings and denied the applications for review.

[554] EchoStar Comments at 11.

[555] Comcast Reply Comments at 18.

[556] Cablevision, the seventh largest MSO, owns news networks, including MSG Metro Traffic and Weather in New York and the News 12 group of regional news services in Connecticut, New Jersey, and Westchester County and Long Island, New York. *See also* App. D, Table D-3.

[557] App. D. Tbl. D-3.

[558] Steve Sullivan, *NECN Comes Into Its Own*, Broadcasting & Cable, May 8, 2000, at 52.

[559] Linda Haugsted, *AT&T Pulls the Plug on BayTV News Network*, Multichannel News, July 9, 2001, at 15.

sports, traffic, and weather, ceased its operations on September 7, 2001, due to declining advertising sales and continued operating losses over the past 22 months.[560]

177. ***PEG Programming***. Public, educational, and government ("PEG") channel set-asides often are required on cable systems by local franchising authorities.[561] Approximately 15 percent of all cable systems carry PEG programming.[562] Cable operators do not have ownership interests in PEG access programming, although some franchise agreements require that they provide services, production facilities, and equipment for the production of local programming. PEG programming is not, therefore, considered vertically integrated.

178. PEG channels are intended to provide community specific information. Since the September 11, 2001, terrorist attacks in New York City and Washington, D.C., many PEG channels are taking part in keeping the public informed about recent events and recovery efforts. Across the country, PEG channels are providing bulletin boards on blood drives, church services, counseling sessions, Web sites, local school activities, call-in programs, civil liberties studies, local civic meetings, and local governmental activities.[563] In addition to PEG channels, some cable operators are also providing local and regional sports, weather, and news programming.[564]

179. In March 1999, Cablevision declined to air a program on its PEG channels in Oyster Bay, New York, when the program *American Defense Monitor* offered transcripts of the program for $5.00 or tapes for $19.95. Cablevision required the programmer to delete the 25-second closing segment which made the offer. The producer complied, but later filed suit in district court claiming that Cablevision was trying to control programming content, thus violating the 1984 Cable Act.[565] The district court found that Cablevision was within its rights to refuse to air a program that included solicitation for its tapes of the show.[566] On August 16, 2001, the U.S. Court of Appeals for the Second Circuit vacated and remanded the lower court's decision.[567] Members and representatives of the industry are concerned that the Appeals Court decision will undermine the social purposes of PEG channels.[568]

180. ***Packaging of Cable Programming Services***. In the *Notice*, we sought information on the extent to which MVPDs offer or plan to offer consumers programming choices on an "a la carte" or

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[560] Linda Haugsted, *Adelphia to Shut Down OCN,* Multichannel News, July 31, 2001, at http://www.tvinsite.com/index.asp...print_page&doc _id=3931&articleID=.

[561] 47 U.S.C. § 531. Local franchise authorities are allowed to establish procedures under which the cable operator may utilize unused PEG channel capacity for other services. 47 U.S.C. § 531(d)(1).

[562] http://www.alliancecm.org/about/info.htm.

[563] E-mail from Bunnie Riedel, Executive Director, Alliance for Community Media, Oct. 15, 2001. In Sacramento, California, volunteers created messages of sympathy and messages in honor of search and rescue personnel; in Multnomah, Oregon, members of the local Muslim Community Center hosted a call-in program; and in Summit, New Jersey, PEG channels covered local prayer services and ran an emergency bulletin board.

[564] NCTA Comments at 30.

[565] 47 U.S.C. § 531.

[566] *Goldberg v Cablevision Systems Corp.*, 69 F.Supp.2nd 398, 399 (E.D.N.Y. 1999).

[567] *Goldberg v. Cablevision Systems Corp.*, No. 99-9411, 2001 WL913555 (2nd Cir. Aug. 14, 2001).

[568] Joe Estrella, *Court Overrules Cablevision's PEG Editing,* Multichannel News, Aug. 27, 2001, at 22.

individual channel basis rather than in tiers of channels. Currently, the majority of programming is offered in tiers. Although some programming is still being offered a la carte, MVPDs are not vigorously marketing such services.

181. In the *2000 Report*, we reported that the sunset of cable rate regulation, digital upgrades, and the resulting ability to deliver more channels of programming that could enable greater flexibility for cable operators in packaging programming channels did not result in a trend to do so.[569] Although digital services are offering various options for channel packages and a la carte tiers, a trend toward more flexible packaging appears to be in the packaging of services, rather than the packaging of channels. For example, in the Boston market, AT&T offers various purchasing plans. A customer can save up to $20.90 per month by subscribing to standard video, digital video, cable Internet service, and local telephone service; up to $10.95 per month by subscribing to standard video, digital video, and local telephone service; or, up to $4.00 per month by subscribing to two of the four service offerings.[570]

182. In Lexena, Kansas, Everest Connections Corporation offers four service packages to its 4,100 plus subscribers in addition to its a la carte offerings. Basic cable, the digital tier, and one local telephone line is available for $49.95 per month. The monthly rate for basic cable, the digital tier, a premium channel, a local telephone line, and 256 kbps Internet downstream is $76.95. Basic cable, the digital tier, two premium channels, a local exchange line, ten custom calling features, voice mail, and 1.5 Mbps Internet downstream is priced at $99.95 per month. The fourth package consists of basic cable, the digital tier, HBO, Cinemax, Showtime, Starz, Encore, ten custom calling features, high-speed Internet, voice mail with increased greeting, message and storage capabilities, plus home/guest mail box features for $129.95 per month.[571]

183. Comcast credits digitization for its ability to provide a wide variety of packages and services to its subscribers.[572] It states that today it routinely offers packages of digital video channels, PPV channels, and VOD as well as the analog packages that it has historically provided. It states that service providers are able to provide their customers with many packaged services such as multichannel video services, telephone services, and high-speed Internet services as a single offering, or with prices for any one group of services discounted for those who buy two or more services. All sizes and types of MVPDs are continuing to provide subscribers with bundles of services.

184. ***Programming Costs***. The Commission's most recent report on cable industry prices ("*2000 Price Survey Report*") asked cable operators to describe factors that led to changes in their rates. Competitive and noncompetitive cable operators attributed 44 percent and 41 percent, respectively, of their rate increases to increases in programming costs.[573]

185. According to Comcast, the costs of acquiring video programming over the past two years has continued to escalate. Comcast states that its programming costs have increased by 13 percent to 15 percent over the past two years. It states that some services have increased by as much as 33 percent. It

[569] *2000 Report*, 16 FCC Rcd at 6085.

[570] AT&T Comments at 25.

[571] Utilicorp Comments at 3.

[572] Comcast Comments at 7-8.

[573] Inflation, channel additions, system upgrades, and equipment costs were also said to account for a large portion of rate increases. *See 2000 Price Survey Report*, 16 FCC Rcd at 4346.

notes that ESPN's rates have increased at the rate of 20 percent per year for the last four years. Comcast also points out that increases in sports licensing fees continue be a cause of price increases for sports channels, even though the ratings for some sports channels are declining.[574]

C. Technical Issues

186. Cable operators and other MVPDs continue to develop and deploy advanced technologies, to increase capacities and enhance the capabilities of their transmission systems.[575] These technologies allow MVPDs to deliver additional video options and other services to their subscribers.[576] In addition, cable operators continue to rebuild their cable plants and to upgrade their facilities for bandwidth expansion through other technical means, such as the electronic component upgrading of existing amplifiers, in order to offer more video programming and other services.[577] In the last year, there have been a number of developments concerning navigation devices and cable modems that are used to access the range of services offered by MVPDs. Most notably, cable operators are favoring less powerful and less expensive set-top boxes, such as Motorola's DCT 2000 and Scientific Atlanta's Explorer boxes.[578] These so-called "thin" boxes would likely require more processing power at the headend or nodal sites to accomplish the same functionalities of the more powerful boxes, such as Motorola's DCT 5000 or the Scientific Atlanta's Explorer 5000 boxes ("thick boxes"). It remains unclear, however, whether the industries have modified their plans for advanced services around these thin boxes. In this section, we address interactive television technologies and update the information provided in the *2000 Report* regarding navigation devices and cable modems.[579]

1. Interactive Television

187. Interactive television ("ITV") services provide, or have the potential to provide, a wide range of services, including VOD, e-mail, TV-based commerce ("e-commerce"), Internet access, PVR functionality, programming-related content, and electronic couponing.[580] In the last year, cable operators have not initiated large-scale ITV service rollouts, focusing instead on upgrading their systems to digital service and rolling out cable modem service.[581] One ITV service to which MSOs have devoted more attention this year is VOD, which qualifies as interactive because the consumer chooses when to buy the programming and has "VCR-like" control over the viewing experience.[582] A variation of this service is subscription VOD, which enables the impulse viewing of a library of programming with full "VCR-like"

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[574] Comcast Comments at 14.

[575] *See 2000 Report*, 16 FCC Rcd at 6087-8.

[576] *See, e.g.*, NCTA Comments at 31-32; DirecTV Comments at 16-17.

[577] *1999 Report*, 15 FCC Rcd at 1067.

[578] *See* Michael Lafferety, *Taking a Look at the Thick and the Thin of It*, CED, Sept. 2001, at 29-44.

[579] *See 2000 Report*, 16 FCC Rcd at 6088-6092.

[580] *2000 Report*, 16 FCC Rcd at 6088. *See also* Michael Grotticelli and Ken Kerschbaumer, *Slow and Steady*, Broadcasting & Cable, July 9, 2001, at 34-38 ("*Grotticelli*").

[581] *Grotticelli* at 34-38. *See also* Andy Grossman, *GMs on Hot Seat to Add Cash Flow; Cable Executives Say Digital Cable and Highspeed Data are Keys to Growth*, Multichannel News, June 4, 2001.

[582] Cable operators use VOD servers located at the cable headend to manage VOD streams. The principal VOD server vendors are Concurrent Computer, Diva, SeaChange, and nCube.

functionality, but for a subscription fee. This model is in contrast to the more traditional pay-per-view requirement of ordering and paying for programming a la carte with the PPV purchase.[583] According to one analysis, VOD will generate revenues of more than $65 million by year-end 2001; $420 million in 2002; $970 million in 2003; $1.43 billion in 2004; and will reach $1.98 billion by year-end 2005.[584]

188. As we discuss in detail above,[585] many of the top MSOs are conducting trials of VOD or have moved to commercial offerings in some markets. Several MSOs also have launched other interactive services in addition to VOD. In September 2001, Cablevision launched its "iO: Interactive Optimum" service in select areas of western Long Island, New York, providing VOD, an interactive programming guide, expanded digital programming, digital music, niche video content, two-way interactive programming, and e-mail.[586] Insight Communications has launched VOD and an information service called Local Source throughout its Indiana, Kentucky, and Ohio markets.[587] In September 2001, the company launched its "Insight Digital Mall," an electronic mall of 40 national and local stores, which, once an electronic wallet account has been established, allows Insight subscribers to purchase select goods and services directly through their televisions.[588] Charter is incorporating Microsoft's Advanced TV software on Motorola DCT-5000 set-tops in order to offer customers Internet-based streaming audio and video, e-mail, VOD, interactive local and national news, and high-speed Internet access.[589]

189. As we reported last year, DBS operators and broadcasters also have entered the ITV market.[590] In addition to rolling out interactive programming guides, DBS operators are integrating PVR technology into their subscriber equipment. DirecTV continues to add features to its "DirecTV Interactive" service launched in October 2000, including on-demand stock quotes, sports information, and

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[583] George Mannes, *Video on Demand Tests Begin as Cable Firms Seek Growth Channels*, TheStreet.com, June 8, 2001.

[584] Yankee Group, *Video-on-Demand Will Generate Revenues of Nearly $2 Billion in 2005* (press release), June 25, 2001.

[585] *See* ¶¶ 40, 41 *supra*.

[586] Cablevision Systems Corp., *Cablevision Introduces iO: Interactive Optimum, Its Suite of New Digital Services in Western Long Island* (press release), Sept. 27, 2001. Among the two-way offerings, the service includes MSG Game Director, which allows subscribers to control their view of live sporting events taking place at Madison Square Garden; PhotoNeTV, which allows customers to create slide shows of personal photos directly on the television screen for viewing, retrieval and storage; and Playjam interactive trivia and games. Niche video content is offered through a service called Mag Rack, which offers on-demand video magazines on a wide range of topics and VCR-like viewing control.

[587] Insight's interactive digital TV service was available to 809,000 customers or 63.4% of the company's total footprint at the end of Q3 2001. *New Services Drive Insight's Revenue Growth*, Broadband-Daily.com, Nov. 7, 2001. Insight claims that digital cable penetration is 30 percent where it has launched interactive services as compared to 17-18 percent digital penetration in markets where interactive services are not available. *Id.*

[588] Insight has partnered with Liberate for set-top box software, CommerceTV for the electronic mall and with SourceMedia for LocalSource local information services. *See* Insight Communications, *Insight Communications Launches Commerce.TV in Lexington* (press release), Sept. 17, 2001.

[589] Rebecca Buckman, *Microsoft Lands TV Software Agreement with Cable Firm Charter Communications*, Wall Street Journal, Nov. 8, 2001 at A4. Charter expects to launch Microsoft TV-based services in early 2002. *Id.*

[590] *2000 Report*, 16 FCC Rcd at 6088-89.

interactive e-commerce.[591] In addition, DirecTV has integrated TiVo and UltimateTV PVR platforms into certain of its set-top boxes. EchoStar has introduced an upgraded digital receiver, which enables it to offer enhanced programming as well as digital video recording capabilities.[592] The four major television networks continue to offer enhanced programming synchronized with online content. For example, ABC synchronizes web-based content with ESPN's *Sunday Night Football* games and ABC's *Monday Night Football* games.[593] During the 2002 Winter Olympics in Salt Lake City, WOW Digital TV and NBC affiliate KSL-TV will conduct a trial of a digital broadcast and interactive service, which will allow customers to call up data and make purchases over their televisions.[594]

190. On January 18, 2001, the Commission released a *Notice of Inquiry* seeking comment on whether rules are necessary to prevent anticompetitive behavior and to promote diversity and capital investments in the ITV market.[595] In this proceeding, some commenters reiterate their concerns regarding the advent of technical advances and the ability to distribute ITV and related advanced services. NAB asserts that new technologies, such as ITV and EPGs, will expand opportunities for cable operators to disfavor competing content and service providers.[596] NCTA disputes this, noting that cable companies and many other providers are in only the early stages of developing a variety of services that might be described as ITV services.[597] It further notes that video content providers are exploring all avenues for

[591] *See* DirecTV, *Personalized On-Demand Stock Quotes on TV – Now a Reality with Bloomberg Television, DirecTV and Wink Communications* (press release), Apr. 2, 2001; DirecTV, *DirecTV, ESPN and Wink Communications Announce Availability of "ESPN Today" on DirecTV Interactive Service* (press release), July 17, 2001; DirecTV, *Wink Communications and Barnes & Noble.com Launch the First National 24/7 Interactive E-Commerce Channel on Television* (press release), Sept. 18, 2001; DirecTV, *DirecTV, Music Choice and Wink Communications Announce New Interactive Television Commerce Service* (press release), Nov. 5, 2001. With respect to the e-commerce offerings, by employing their remote control, DirecTV customers can buy the top 100 best selling books on Barnes and Noble.com and can buy CDs containing the song they are listening to on music channels. DirecTV also includes in its programming lineup ShopNBC which offers "click and buy" interactivity via Wink technology.

[592] EchoStar, *EchoStar Introduces DISH Network PRO 501 – Premium Satellite Television Receiver Featuring Digital Video Recording, Interactive TV* (press release), Jan. 8, 2001.

[593] For a description of ABC Enhanced TV, *see* http://heavy.etv.go.com/etvHome/tour.shtml.

[594] In this trial, viewers will be able to receive digital broadcasts of Olympics coverage on their analog sets by using a WOW Digital TV proprietary set top box, which will be connected to a telephone line to allow interaction with the programming. OpenTV is providing the interactive-enabling software. Michael Grotticielli, *Putting Some Wow in DTV*, Broadcasting & Cable, Nov. 5, 2001; WOW Digital TV, *WOW Digital TV Formed to Deploy First Enhanced Digital Broadcast Platform for U.S. Broadcasters and Viewers* (press release), Nov. 5, 2001.

[595] *Nondiscrimination in the Distribution of Interactive Television Services Over Cable*, CS Docket No. 01-7, Notice of Inquiry, 16 FCC Rcd 1321 (2001).

[596] NAB Comments at 4. NAB also states that the delivery of digital ITV services will, unlike analog, require a mechanism for associating all of the video, audio and data elements comprising any interactive service, and cable operators will control this mechanism in the form of EPGs, thus expanding the opportunity for cable operators to discriminate against the offerings of unaffiliated entities and other disfavored competitors such as broadcasters. *Id.* at 5.

[597] NCTA at 13.

distribution, including DBS, wireless transport, DSL, digital broadcasting, and telephone lines for both the downstream and upstream components of ITV services.[598]

2. Navigation Devices

191. Section 629 of the Communications Act directed the Commission to adopt rules that would allow consumers to obtain "navigation devices," such as cable set-top boxes, remote control units, and other equipment, from commercial sources other than their cable providers.[599] In 1998, the Commission adopted rules that require MVPDs to unbundle security from other functions of the navigation device, and by July 1, 2000, to make available point-of-deployment modules ("PODs") to perform this function.[600] On reconsideration, the Commission deferred application of the rules requiring a separate security module for analog-only devices.[601] Thus, an MVPD subscriber will be able to obtain a set-top box without the security features ("host device") from retailers and only remain reliant on the MVPD to provide a POD for security functions.[602] Despite the availability of PODs, CEA maintains that retailers have not been carrying cable set-top boxes.[603]

192. Through the OpenCable project, CableLabs has developed specifications for the POD module as well as the interface that a host device needs to accommodate the POD. CableLabs also developed the POD-Host Licensing Agreement ("PHILA") to provide manufacturers with the necessary technology to make PODs work in host devices.[604] Consumer electronics manufacturers contend that the standards developed by CableLabs are not sufficiently settled to allow the manufacture of set-top boxes that are competitive with the equipment supplied to subscribers by cable operators.[605]

193. CableLabs is continuing its efforts to develop next generation navigation devices with its initiative for the OpenCable Application Platform ("OCAP") or "middleware" specification. This

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[598] *Id.* at 14.

[599] 47 U.S.C. § 549.

[600] *Navigation Report and Order*, n. 96 *supra*. On August 14, 2000, the Commission adopted a *Memorandum Opinion and Order*, which granted waivers of the July 1, 2000, compliance date for a limited number of cable operators that use hybrid navigation devices. The Commission established a revised compliance date for each of the individual systems involved, with no waiver granted beyond December 31, 2001. *Charter Communications, Inc., AT&T Broadband, L.L.C., Insight Communications Company, L.P., Cox Communications, Inc., GCI Cable Inc., Cablevision Systems Corp., Adelphia Communications Corp., MediaCom Communications Corp., CableAmerica Corp., Time Warner Cable, Petition for Waiver of the Requirement To Provide Point of Deployment Modules Contained in Section 76.1204 of the Commissions Rules*, CSR Nos. 5545-Z, 5548-Z, 5558-Z, 5561-Z, 5564-Z, 5566-Z, 5567-Z, 5569-Z, 5570-Z, 5572-Z, Memorandum Opinion and Order, 15 FCC Rcd 15075 (2000).

[601] 47 C.F.R. § 76.1204. *See also Navigation Reconsideration supra* n. 96.

[602] The POD requirement is intended to permit portability among set-top boxes, which will increase the market base and facilitate volume production. *Navigation Report and Order*, 13 FCC Rcd at 14793-4.

[603] CEA Comments at 2.

[604] Motorola and Scientific Atlanta have signed the PHILA and CableLabs is engaged in negotiations over the PHILA with other manufacturers. Letter from William A. Check, Ph.D., Vice President, Science and Technology, NCTA, to Magalie R. Salas, Secretary, FCC, Oct. 31, 2001.

[605] Letter from Michael Petricone, Vice President, Technology Policy, CEA, to Magalie R. Salas, Secretary, FCC, Nov. 6, 2001.

specification includes a set of Application Programming Interfaces ("APIs") designed to enhance the portability of OpenCable products across brands and operating systems. CableLab plans to release the OCAP specification by February 1, 2002.[606] CEA maintains that until this software standard is complete, manufacturers will not be able to build advanced set-top boxes for a retail market.[607] In another effort intended to facilitate the retail availability of set-top boxes, cable operators announced an initiative to encourage their set-top box suppliers to make their digital set-top boxes with embedded security available at retail.[608]

3. Cable Modems

194. A cable modem allows cable subscribers to access high-speed data services and interactive television, including the Internet, Internet Protocol ("IP") telephony, video conferencing, and telecommuting. Cable modem deployment continues to increase.[609] As we previously reported, the CableLabs Certified Cable Modem Project (formerly known as Data Over Cable Service Interface Specification or DOCSIS) defines interface requirements for high-speed cable modems and provides a method for certifying that cable modems available for retail sale are in compliance with the DOCSIS specifications.[610] As of December 2001, CableLabs had certified 193 DOCSIS 1.0 modems and 26 cable modem termination systems ("CMTS").[611] CableLabs also has developed an enhanced specification, DOCSIS 1.1, which provides for high-speed Internet service tiers, using techniques known as data fragmentation and quality of service. Under this specification, which is compatible with the existing DOCSIS 1.0 specification, cable operators can deliver high-speed Internet services simultaneously over the same plant and in a path parallel to core video services. To date, CableLabs has certified nine high-speed cable modems that comply with the DOCSIS 1.1 specification, and two companies have received qualification status for their DOCSIS 1.1 cable modem termination systems.[612] Recently, CableLabs announced the next version of the specification, to be called DOCSIS 2.0, which will significantly increase cable bandwidth for data transmissions without requiring any physical rebuilding of cable

[606] Letter from William A. Check, Ph.D., Vice President, Science and Technology, NCTA, to Magalie R. Salas, Secretary, FCC, Oct. 31, 2001.

[607] Letter from Michael Petricone, Vice President, Technology Policy, CEA, to Magalie R. Salas, Secretary, FCC, Nov. 6, 2001.

[608] Letter from Robert Sachs, CEO, NCTA, to Michael Powell, Chairman, FCC, Oct. 10, 2001.

[609] *See* ¶¶ 44-8 *supra*.

[610] *2000 Report*, 16 FCC Rcd at 6092. *See also* CableLabs at http://cablemodem.com.

[611] CableLabs, *CableLabs Certifies 7 More DOCSIS 1.1 Modems, Continuing Cable Data Advances* (press release), Dec. 20, 2001, at http://cablelabs.com/news_room/PR/01_pr_cw20_122001.html.

[612] *Id. See also* CableLabs, *Certifies Two DOCSIS 1.1 Modems and Qualifies Two CMTS, Achieving Breakthrough on Advanced Devices* (press release), Sept. 27, 2001, at http://www.cablelabs.com/news_room/PR/00_pr_cw19_092701.html. Companies receiving certification are Ambit, Arris, Ericsson, Scientific-Atlanta, Tellabs, and, for two modems apiece, Toshiba and Texas Instruments. Arris and Cadant gained qualification status for their cable modem termination systems.

networks.[613] DOCSIS certified cable modems are now being sold at retail in some markets, although widespread retail availability has not yet occurred.[614]

195. PacketCable, another CableLabs project, is intended to develop interoperable interface specifications for delivering advanced, real-time multimedia services over two-way cable plant. PacketCable will use IP technology to enable a wide range of services, including IP telephony, multimedia conferencing, interactive gaming, and general multimedia applications.[615] In November 2000, CableLabs announced that it had completed the second phase of the PacketCable project and had released several new interim specifications and technical reports.[616] These specifications, which build upon the capabilities defined by the PacketCable 1.0 suite of specifications, describe call signaling, quality-of-service, and event messaging extensions that will enable cable operators to directly exchange multimedia traffic over managed-IP backbone networks. Future extensions to the PacketCable specifications will define protocols for enhanced capabilities, such as multimedia conferencing and interactive gaming. CableLabs observes that several vendors participating in this project are developing products based on the PacketCable specification.

IV. COMPETITIVE RESPONSES

196. In this section, we describe a number of cases where the incumbent cable operator faces competition from a new entrant. We report information gathered through comments filed in this proceeding, petitions filled with the Commission for a determination of effective competition, trade press reports, articles, and other publicly available sources.

197. Between July 2000 and June 2001, the Bureau granted 16 petitions for effective competition, representing 240 communities, based on competitive entry from LECs or their affiliates, DBS, and municipal operators. These communities represent approximately two percent of all cable subscribers. The differences between competition and general market responses based on technological advances, improved marketing, and new service opportunities are not always easy to distinguish. However, in communities where head-to-head competition is present, the incumbent cable operator has generally responded to competitive entry in a variety of ways, such as by lowering prices, providing additional channels at the same monthly rate, improving customer service, adding new services, or by challenging the legality of the entrant's activities.

198. For example, in Boston, Massachusetts, in response to RCN's entry, the incumbent cable operator in Boston, Cablevision of Boston ("Cablevision"), "moderated" its regional rate increase in the Boston area and agreed to improve its commitment to public and educational channels.[617] RCN, a wholly owned subsidiary of RCN Telecom Services Inc., initially entered the Boston area market in 1996 as an OVS operator.[618] It was granted a 15-year cable franchise by the City of Boston on July 27, 1999. By

[613] CableLabs, *CableLabs Creating Advanced Modem Spec to Enable 30 Mbps in Upstream* (press release), Aug. 31, 2001, at http://www.cablelabs.com/news_room/PR/01_pr_adv_phy_083101.html.

[614] Kinetic Strategies, Inc., *Cable Modem FAQ*, at http://www.cabledatacomnews.com/cmic/cmic2.html.

[615] *See* CableLabs at http://www.packetcable.com. *See also 2000 Report*, 16 FCC Rcd at 6092.

[616] CableLabs, *Cablelabs Releases New Interim PacketCable Specifications* (press release), Nov. 28, 2000, at http://www.cablelabs.com/news_room/PR/00_pr_pc_specs_112800.html.

[617] RCN Comments at App. A.

[618] *Cablevision Petition for Special Relief*, CSR 5048-E, Aug. 3, 1999, at 2.

September 1999, RCN served a total of 11,000 subscribers in the Boston metropolitan area, including 5,000 subscribers in the City of Boston.[619] By comparison Cablevision serves about 140,000 subscribers in Boston.[620]

199. RCN contends that, because of its entry to the Boston area, the City of Boston was able to negotiate a franchise renewal with Cablevision that imposed obligations on the incumbent more favorable to the public than would otherwise have been possible.[621] The franchise agreement requires Cablevision to upgrade its system capacity within three years to offer more channels, as well as local telephone and high-speed Internet access.[622] Initially Cablevision took steps to prevent RCN from going forward by filing a lawsuit against RCN and the city.[623] Furthermore, RCN contends that Cablevision created a barrier to entry by refusing RCN access to inside wiring in MDUs in the Boston area.[624]

200. Lower monthly rates and added or improved services were also found in a number of other communities where the incumbent cable operator faced new entrants. For example, in Duluth, Georgia, the incumbent Rifkin & Associates, Inc./Cable Equities of Colorado, Ltd. ("Rifkin") faced aggressive advertising aimed at its subscribers, accompanied by extensive press coverage in the local media, from new entrant BellSouth Interactive Media Services, Inc. ("BIMS").[625] In response to aggressive competition from BIMS, Rifkin upgraded its system and added 19 new channels -- nine new expanded basic channels, a low priced, three-channel new product tier, and seven PPV channels.[626]

201. Similarly, RCN contends that in Somerville, Massachusetts, upon its entry, Time Warner, the incumbent, announced a rate freeze for only that area where it faced competition.[627] In suburban Philadelphia, as a result of RCN's entry, Comcast, the incumbent, began to offer "rate locks" and service improvements in the towns where it faced competition.[628] In the Washington, D.C., area, as a result of entry by Starpower, an RCN affiliate, Comcast, the incumbent cable operator, reduced a previously proposed rate increase. RCN also contends that in anticipation of its entry in Fairfax County, a suburb of Washington, D.C., the incumbent Cox announced an upgrade of its plant.[629]

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[619] RCN Comments at 5.

[620] On Jan. 5, 2001, AT&T acquired the Cablevision system that serves the Boston franchise area.

[621] RCN Comments at App. A.

[622] Bruce Mohl, *City Hopes Cable Pact Means Rate War,* Boston Globe, July 29, 1999, at 32.

[623] *City of Boston Application for Review of Determination of Effective Competition In Re Cablevision of Boston, Inc.*, CSR 5048-E, Aug. 20, 2001, at 2. *See also Cablevision of Boston, Inc., Petition for Determination of Effective Competition*, DSR 5048-E, Memorandum Opinion and Order, 16 FCC Rcd 14056 (2001).

[624] *See* ¶ 133 *supra.*

[625] *Rifkin & Associates, Inc./Cable Equities of Colorado, Ltd., Petition for Determination of Effective Competition* at Exhibits D - F.

[626] *Id.* at 10.

[627] *See 1999 Report,* 15 FCC Rcd at 1073.

[628] RCN Comments at App. A.

[629] *Id.*

202. In some situations questions have been raised regarding the techniques used by incumbent service providers to forestall competition. In Scottsboro, Alabama, the Scottsboro Electric Power Board ("Scottsboro") began construction of a new, municipally owned cable television system in Scottsboro because of widespread dissatisfaction with Falcon Cablevision ("Falcon"), the incumbent cable operator.[630] In late 1999, Charter Communications ("Charter") acquired Falcon's operation in Scottsboro. After acquiring the system, Charter began to engage in a course of conduct that, according to Scottsboro, is designed to terminate Scottsboro's efforts to compete in the market and, moreover, to signal other would-be competitors that attempts to enter other Charter markets would lead to similar predatory practices.[631]

203. Since beginning in April 2000, Charter offered a special rate of $19.95 per month for one year. It then allowed some customers to continue subscribing at that rate for a second year. In May 2000, Charter added one month of free service to the $19.95 rate.[632] Scottsboro contends that Charter's special rates are available only to Scottsboro's customers and are not available to all potential subscribers in Scottsboro.[633]

204. According to Scottsboro, Charter normally charges $24.95 per month for its expanded basic service, which includes 200 channels comprised of 16 premium movie channels, 45 digital music channels, 16 educational channels, and 14 PPV channels. A digital receiver with remote and Charter's on-screen guide are also included. Furthermore, Charter offers a $200 "bounty" to switch from Scottsboro to Charter, and an additional $200 if subscribers take its Internet service. In addition, Charter established a system under which it retired subscribers' old debts. Scottsboro states that Charter's special offerings have induced about 36 percent of Scottsboro's customers to switch to Charter.

205. Charter counters that Scottsboro has easy access to every citizen because of its advantageous position as a municipally owned-cable system; it also has wide public support, low capital costs, and the incumbent system against which it formerly competed was in dire need of an upgrade. According to Charter, it upgraded the system after purchasing it from Falcon, and the system is now able to provide cable modem service and digital programming at competitive rates.[634] Charter admits that it has conducted "win back" campaigns, but claims that such campaigns are widespread among cable television operators. It also denies that it has set its prices at predatory rates and maintains that its actions and pricing policies have benefited subscribers in the community because they now enjoy lower monthly charges for improved services.[635]

206. Knology submits that Charter has engaged in similar behavior against its systems in West Point, Georgia, and Montgomery, Alabama.[636] Knology has provided cable service in West Point since 1998.[637] In 1999, Charter purchased the incumbent cable system from Marcus Cable. After Knology

[630] Scottsboro Comments at 5.

[631] *Id.* at 1.

[632] *Id.* at 5.

[633] *Id.* at 7.

[634] Charter Reply Comments at 1.

[635] *Id.* at 2- 3.

[636] Knology Comments at 1.

[637] *Id.* at 3-4.

entered the market, several rounds of lowering prices occurred until both providers were charging about $20 for expanded basic service. Knology contends that Charter did not offer the same discounted rates in nearby communities. According to Knology, in nearby communities, Charter's prices ranged to more than $35 per month for expanded basic, more than the national average of $32.25.[638] In addition, earlier this year, Charter began offering a "bounty" of $200 and free installation to any consumers that switched from Knology to Charter. Knology states that, for customers taking advantage of this offer, the effective cost of cable service was reduced to less than $4 per month.[639] In Montgomery, Knology purchased an existing competitive system in 1997.[640] When Charter acquired the incumbent cable system in 2001 from AT&T Broadband, it immediately lowered the price of its digital tier and offered consumers $300 to switch from Knology to Charter. According to Knology, Charter recently began to offer a "digital complete basic" service for less than $23 per month, which includes all analog expanded basic services, 50 channels available only on the digital tier, and 50 channels of digital music. In addition, Charter will forgive old debts to Charter or the system's previous owner. Knology alleges that Charter's discounts and giveaways have reduced its prices below costs, even if only programming costs are considered. Knology contends that Charter is taking a significant loss on each new customer it takes from its competitors, but it will be able to recoup its losses once it has driven its competitors out of the market.[641]

207. In previous *Reports*, we have examined responses to head-to-head competition. In communities where cable operators have faced competition for a substantial period of time, the initial competitive response generally gives way to a more mature form of competition that benefits both subscribers and operators. In Omaha, Nebraska, where Cox and Qwest have been competing for the past six years, both offer a bundle of video, telephony, and high-speed Internet access services to entice new customers and retain old ones.[642] For example, Qwest's phone customers pay $28.95 per month for 59 channels of basic cable service and $39.95 per month for cable modem service. For its part, Cox charges $33.95 per month for its 70 channel basic cable service and its cable modem service is $5.00 lower than Qwest's charge for cable modem service. As result of this competition, cable penetration in the area has increased and "churn" has stabilized.[643]

208. As the cases presented above suggest, subscribers usually benefit from "head-to-head" competition. In communities where "head-to-head" competition has been sustained for a long period of time, customers generally receive lower monthly rates and better service, while operators generally enjoy higher penetration rates and lower churn rates. Commenters report that, however, in some cases, particularly where a new entrant may appear vulnerable for financial or other reasons, the initial response of a large incumbent MSO to competition may be motivated by anticompetitive animus rather than legitimate business concerns.[644] Further, commenters informed us that, because of the difficulty and cost

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[638] *Id.* at 4.

[639] *Id.*

[640] *Id.* at 5-6.

[641] *Id.* at 6. *See also* Scottsboro Comments at 6-7.

[642] Matt Stump, *In Omaha, Cox and Qwest Wage Three-Way Contest,* Broadband Week, Oct. 1, 2001.

[643] *Id.*

[644] Knology Comment at 6-8; Scottsboro Reply Comment at 2-3.

of pursuing antitrust remedies, it may be that the target of anticompetitive conduct is without practical remedy.[645]

209. The allegations made in the comments of Scottsboro and Knology highlight the difficulties of new entrants that, for whatever reason, are capable of competing only within a confined geographic region. The vast resources of a large MSO may simply prove too much if brought to bear in a targeted fashion against a single system entrant. Moreover, we are concerned about the signal such targeting may send to others who would compete in the MVPD market, and particularly to the financial markets to which a new entrant may well be dependent for resources. However, it is not clear that we have specific statutory authority to address these kinds of problems directly. There has been some suggestion that our authority to prohibit anticompetitive acts or unfair practices under section 628 of the Act would reach targeted and predatory competitive responses.[646] Alternatively, it may be that we would have to seek additional authority from Congress in order to combat such practices, which tend to limit competition and discourage new entry.

V. ADMINISTRATIVE MATTERS

210. This *2001 Report* is issued pursuant to authority contained in sections 4(i), 4(j), 403, and 628(g) of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154(i), 154(j), 403, and 548(g).

211. It is ORDERED that the Office of Legislative and Intergovernmental Affairs shall send copies of this *2001 Report* to the appropriate committees and subcommittees of the United States House of Representatives and the United States Senate.

212. It is FURTHER ORDERED that the proceeding in CS Docket No. 01-129 IS TERMINATED.

FEDERAL COMMUNICATIONS COMMISSION

Magalie Roman Salas

Magalie Roman Salas
Secretary

[645] Cable Services Bureau staff meeting with Scottsboro, Oct. 17, 2001.

[646] Scottsboro Comment at 7-9; Knology Comments at 6-7.