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Before the
Federal Communications Commission
Washington, D.C. 20554

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

REPORT AND ORDER

Adopted: June 13, 2002 **Released: June 28, 2002**

By the Commission: Commissioner Abernathy dissenting and issuing a statement; Commissioner Copps issuing a statement; and Commissioner Martin approving in part, concurring in part, and issuing a statement.

I. INTRODUCTION

1. We issue this *Report and Order* ("*Order*") in accordance with Section 628(c)(5) of the Communications Act of 1934, as amended ("Communications Act").[1] Section 628(c)(2)(D) generally prohibits, in areas served by a cable operator, exclusive contracts for satellite cable programming or satellite broadcast programming between vertically integrated programming vendors and cable operators.[2] Section 628(c)(5) directs that the prohibition on exclusive programming contracts contained in Section 628(c)(2)(D) shall cease to be effective on October 5, 2002, unless the Commission finds that such prohibition "continues to be necessary to preserve and protect competition and diversity in the distribution of video programming." The Commission issued a *Notice of Proposed Rulemaking* seeking comment on the possible sunset of Section 628(c)(2)(D).[3] By this *Order*, we retain for five years, until October 5, 2007, the prohibition on exclusive programming contracts contained in Section 628(c)(2)(D).

[1] 47 U.S.C. § 548(c)(5).

[2] 47 U.S.C. § 548(c)(2)(D).

[3] *Implementation of the Cable Television Consumer Protection and Competition Act of 1992 - Development of Competition and Diversity in Video Programming Distribution: Section 628(c)(5) of the Communications Act: Sunset of Exclusive Contract Prohibition*, 16 FCC Rcd 19074 (2001) ("*Notice*"). A list of commenters and reply commenters and the abbreviations by which they are identified herein is attached as Appendix A.

2. In undertaking our analysis in this proceeding, we first examine the question of the correct standard to apply in determining whether to continue the exclusivity prohibition. As a backdrop to our analysis, we examine the changes that have occurred in the multichannel video programming distribution market over the past decade beginning with the enactment of Section 628 as part of the Cable Television Consumer Protection and Competition Act of 1992 ("1992 Cable Act")[4] through the present. We then consider whether, as Congress concluded in 1992, vertically integrated program suppliers today retain both the incentive and ability to favor their affiliated cable operators over nonaffiliated cable operators and program distributors using other technologies such that competition and diversity in the distribution of video programming would not be preserved and protected. As part of this analysis, we examine whether a partial sunset of the exclusivity prohibition may be appropriate as to a class of multichannel video programming distributors ("MVPDs") or a subset thereof. We examine whether the prohibition remains necessary to preserve and protect diversity in the distribution of video programming. We also address requests to either narrow or expand the scope of the prohibition. Finally, we discuss a new five-year term, *i.e.*, until October 5, 2007, for the extension of Section 628(c)(2)(D).

3. In examining whether the exclusivity prohibition "continues to be necessary," we find guidance in the concerns Congress expressed in 1992, however, our analysis places substantial weight on whether, in the absence of the exclusivity prohibition, vertically integrated programmers would currently have the incentive and ability to favor their affiliated cable operators over nonaffiliated cable operators and program distributors using other technologies and, if they would, whether such behavior would result in a failure to protect and preserve competition and diversity in the distribution of video programming. The *Order* notes that Congress acknowledged that the enforcement of the prohibition on exclusivity against all vertically integrated programmers may not always serve the public interest, and that retention of the exclusivity prohibition does not foreclose all exclusive arrangements between vertically integrated programmers and cable operators. The *Order* finds that Congress explicitly recognized the existence of such programming by creating the public interest exception to the prohibition. The *Order* acknowledges the significant changes in the MVPD market over the last decade, and finds that, vertically integrated programmers generally retain the incentive and ability to favor their cable affiliates over nonaffiliated cable operators and other competitive MVPDs to such a degree that, in the absence of the prohibition, competition and diversity in the distribution of video programming would not be preserved and protected.

4. With regard to the ability of programmers to favor their cable affiliates over other MVPDs, the *Order* finds that access to vertically integrated programming continues to be necessary in order for competitive MVPDs to remain viable in the marketplace. An MVPD's ability to provide service that is competitive with an incumbent cable operator is significantly harmed if denied access to "must have" vertically integrated programming for which there are no good substitutes. The *Order* also finds that vertically integrated programmers retain the incentive to favor their affiliated cable operators over competitive MVPDs such that competition and diversity in the distribution of video programming would not be preserved and protected. Cable operators today continue to dominate the MVPD marketplace and that horizontal consolidation and clustering combined with affiliation with regional programming, have contributed to cable's overall market dominance. The *Order* finds that an economic basis for denial of access to vertically integrated programming to competitive MVPDs continues, and that such denial would harm such competitors' ability to compete for subscribers. The *Order* finds that a partial sunset of the exclusivity prohibition is not warranted at this time, and that extending the prohibition on exclusivity remains necessary to preserve and protect diversity in the distribution of video programming.

[4] Cable Television Consumer Protection and Competition Act of 1992, Pub. L. No. 102-385, 106 Stat. 1460 (1992).

5. The Order finds that the scope of the exclusivity prohibition should not be narrowed to apply to particular types of programming or specified geographic areas. The Order also rejects expanding the prohibition to terrestrially delivered programming or non-vertically integrated programming. Finally, during the year before the expiration of the exclusivity prohibition on October 5, 2007, the Commission will undertake a review to again determine whether the prohibition continues to be necessary. During this five-year period, the Commission will continue to evaluate petitions for exclusivity, under the public interest factors established by Congress. We find, however, that if a dramatic shift in the competitive landscape should occur before five years, the Commission may initiate its review earlier on its own motion or in response to a petition.

II. BACKGROUND

6. Congress, in the 1992 Cable Act, was concerned that because ". . . cable system[s] face[d] no local competition . . . [t]he result is undue market power for the cable operator as compared to that of consumers and video programmers."[5] The lack of competition to cable in the delivery of multichannel programming enabled cable operators to engage in anticompetitive behavior to the detriment of subscribers, nascent competitors, and nonaffiliated programmers. Congress sought to address this concern in two ways: (i) by imposing specific conduct restrictions that were intended to ameliorate the adverse consequences attendant to the absence of robust competition, such as customer service requirements and the regulation of the rates that cable operators charged for certain equipment and services; and (ii) by imposing (or in some cases eliminating, as in the case of certain ownership restrictions) obligations that it believed would increase competition to incumbent cable operators.

7. One means of increasing competition in the distribution of programming was to prohibit contractual exclusivity,[6] absent a public interest finding, in the sale of programming so that new entrants would have access to programming that was considered critical to competitive survival.[7] Congress did so

[5] 1992 Cable Act § 2(a)(2).

[6] Congress absolutely prohibited exclusive contracts between vertically integrated programming vendors and cable operators in areas unserved by cable, and generally prohibited exclusive contracts within areas served by cable. 47 U.S.C. § 548(c)(2)(C); 47 U.S.C. § 548(c)(2)(D). Specifically, the prohibition with regard to served areas, Section 628(c)(2)(D), states that:

> with respect to distribution to persons in areas served by a cable operator, [the Commission shall] prohibit exclusive contracts for satellite cable programming or satellite broadcast programming between a cable operator and a satellite cable programming vendor in which a cable operator has an attributable interest or a satellite broadcast programming vendor in which a cable operator has an attributable interest, unless the Commission determines . . . that such a contract is in the public interest.

47 U.S.C. § 548(c)(2)(D); *see also* 47 C.F.R. § 76.1002(c)(2). Congress recognized that, in areas served by cable, some exclusive contracts may serve the public interest by providing offsetting benefits to the video programming market or may aid in the development of competition among MVPDs. Congress instructed the Commission to determine whether an exclusive contract is in the public interest by considering five factors in relation to the effect of such contract on the distribution of video programming in that area. 47 U.S.C. § 548(c)(4); *see also* 47 C.F.R. § 76.1002(c)(4).

[7] The record before Congress, leading up to and including the 1992 Cable Act, was replete with references to the importance of access to vertically integrated programming to competitive MVPDs. *See* S. Hrg. 101-357: Media Ownership: Diversity and Concentration, 101st Cong., 1st Sess. 376 (1989) (statement of Gene Kimmelman, (continued....)

based on certain findings and basic assumptions. First, Congress found that increased horizontal concentration of cable operators, combined with extensive vertical integration, created an imbalance of power, both between cable operators and program vendors and between incumbent cable operators and their multichannel competitors.[8] Congress determined that this imbalance of power limited the development of competition among MVPDs and restricted consumer choice.[9] Second, the structure and legislative history of the 1992 Cable Act suggest that Congress believed it unlikely that new market entrants could compete effectively unless they could gain access to vertically integrated, satellite delivered programming.[10] It was this programming that Congress believed incumbent providers had both the incentive and the ability to deny to new competitors.[11] In terms of the nature of the competitors it anticipated, Congress explicitly expected competition to incumbent cable operators to develop from cable overbuilders, MMDS operators, SMATV systems, and DTH satellite providers (C-band and DBS).[12]

8. Finally, although the prohibition on exclusive contracts was intended to provide these new market entrants with a measure of protection, Congress recognized that exclusivity can be a legitimate business practice where there is competition.[13] Accordingly, Congress provided that the prohibition would terminate at the end of 10 years unless the Commission, after conducting a proceeding, found that the prohibition on exclusive contracting "continues to be necessary to preserve and protect competition and diversity in the distribution of video programming."[14]

(...continued from previous page)
Legislative Director, Consumer Federation of America); S. Hrg. 101-511: Competitive Problems in the Cable Television Industry, 101st Cong., 1st Sess. 463 (1990) (statement of Robert L. Schmidt, President Wireless Cable Association); S. Hrg 101-702: Cable TV Consumer Protection Act of 1989, 101st Cong., 2nd Sess. 472-73 (1990) (statement of Harry P. Cushing, President, Telesat Cablevision, Inc.); Cable TV Consumer Protection Act of 1991, Hearings on S. 12 before the Subcomm. on Communications, Senate Commerce, Science, and Transp. Comm., 102nd Cong., 1st Sess. 280, 283 (1991) (statement of Robert L. Schmidt, President, Wireless Cable Association); *see also* Nicholas W. Allard, The 1992 Cable Act: Just the Beginning, 15 Hastings Communications and Entertainment L. J. 305, 315-317 n. 43 (discussing prior versions and legislative history of the 1992 Cable Act).

[8] 1992 Cable Act § 2(a)(2).

[9] *Id.*

[10] *See* S. Rep. No. 102-92 at 28 (1992).

[11] *Id.; see also* 1992 Cable Act § 2(a)(5).

[12] *See* 47 U.S.C. § 548 (affording program access protection to "multichannel video programming distributors"); *see also* 47. U.S.C. § 522(13) ("multichannel video programming distributor" means "a person such as, but not limited to, a cable operator, a multichannel multipoint distribution service, a direct broadcast satellite service, or a television receive-only satellite program distributor, who makes available for purchase, by subscribers or customers, multiple channels of video programming").

[13] S. Rep. No. 102-92 at 28.

[14] 47 U.S.C. § 548(c)(5). Section 628(c)(5) of the Communications Act provides that:

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

47 U.S.C. § 548(c)(5); *see also* 47 C.F.R. § 76.1002(c)(6).

9. During this ten-year period, the restrictions on exclusive programming contracts were intended to prohibit anticompetitive practices, foster the development of emerging competitors to cable, and level the competitive field for smaller MVPD competitors. The Commission therefore issued its *Notice* in this proceeding in order to determine whether competition to incumbent cable operators has reached the point at which the exclusivity prohibition no longer is necessary, or whether an extension of the prohibition is required.

III. STANDARD FOR REVIEW

10. At the outset, there is a question as to how to interpret the statutory standard the Commission must apply in determining whether to continue the prohibition in Section 628(c)(2)(D). Several cable multiple system operators ("MSOs") state that there is an unambiguous presumption that the prohibition against exclusive video programming contracts will sunset in October 2002.[15] AT&T and NCTA argue that the sunset of Section 628(c)(5) is not merely conditional and that Congress expected the prohibition to sunset, unless extraordinary circumstances convince the Commission that it is necessary to retain the prohibition.[16] Comcast asserts that, the Commission must find substantial evidence to support a conclusion that the rule remains necessary to preserve and protect competition.[17] It argues that the burden of demonstrating a continued need for Section 628(c)(2)(D) is "insurmountable."[18] AOLTW states that any analysis starts with the proposition that there must be substantial and specific evidence establishing that, without retention, competition and diversity in the distribution of video programming could not be preserved and protected.[19]

11. Citing the United States Court of Appeals for the District of Columbia Circuit's decisions in *Sinclair Broadcast Group, Inc. v. FCC*[20] and *Fox Television Stations, Inc., v. FCC*,[21] AOLTW argues that Congress' use of the word "necessary" in Section 628 imposes "an affirmative obligation on the Commission to justify retention of the ownership rules in question based on specific factual evidence in the record...."[22] AOLTW asserts that evidence that retention would be "helpful," "beneficial" or "consonant with the public interest" is not enough; the rule may be retained only if shown to be "necessary to preserve and protect competition and diversity."[23]

12. Responding to AOLTW's argument, WCA and BellSouth argue that regardless of where the burden of proof lies, the Commission has broad discretion to determine whether preserving the ban on exclusivity continues to be necessary.[24] DBS providers and other competitive MVPDs argue that this

[15] AT&T Comments at 1-6; NCTA Comments at 2-4; AOLTW Reply Comments at 2; Comcast Comments at 3.

[16] AT&T Comments at 5; NCTA Comments at 4.

[17] Comcast Comments at 3.

[18] *Id.* at 4.

[19] AOLTW Reply Comments at 2.

[20] 284 F.3d 148 (D.C. Cir. 2002).

[21] 280 F.3d 1027 (D.C. Cir. 2002).

[22] AOLTW Supplemental Comments at 3.

[23] *Id.*

[24] Wireless Communications Association International, Inc. ("WCA")/BellSouth Entertainment, LLC May 8, 2002 *ex parte* letter at 1-2.

inquiry does not require the Commission to prove that competition and diversity cannot under any circumstances be protected in the absence of Section 628(c)(2)(D), nor does it require the Commission to eliminate Section 628(c)(2)(D) unless "extraordinary circumstances" convince the Commission that it is necessary to retain the prohibition.[25] EchoStar emphasizes that there should be no presumption one way or the other and instead the provision provides for a review in the final year of the 10-year period so that the Commission can assess the current status of the competitive marketplace to determine whether the original rule has outlived its usefulness.[26] Media Access Project *et al.* asserts that for a variety of reasons the drafters of this provision recognized that real competition might not emerge after 10 years and left it to the Commission to make the determination as to whether the prohibition continues to serve a purpose.[27] RCN argues that the existence of the provision in Section 628(c)(5) specifically contemplating an extension reveals not confidence, but a concern that a 10-year prohibition might not be sufficient.[28] Thus, according to RCN, in the face of an anticompetitive record, including the lack of access to available programming, Congress imposed a ban for a period of years and left it to the Commission to determine at the end of that period whether to continue the ban, taking into account the facts at that time.[29]

13. We approach this issue as one of statutory construction and thus begin with the plain language of Section 628(c)(5). The statute clearly states that unless the Commission decides that the program exclusivity provision "continues to be necessary to preserve and protect competition and diversity in the distribution of video programming," the provision will sunset on October 5, 2002. The parties, however, raise the question of what exactly the Commission must find in determining whether the provision "continues to be necessary to preserve and protect competition and diversity."

14. The parties focus on the word "necessary." The term "necessary" has been interpreted differently depending on the statutory context. For example, the United States Supreme Court has interpreted the term to mean "useful," "convenient," or "appropriate."[30] The term has also been read in other contexts in a more restrictive sense to mean "indispensable" or "essential."[31]* We do not believe the

[25] DIRECTV Reply Comments at 10; Joint Reply Comments at 11.

[26] EchoStar Reply Comments at 4, 6.

[27] Media Access Project, *et al.* Reply Comments at 8.

[28] RCN Reply Comments at 23.

[29] *Id.*

[30] *See e.g., Morgan v. Commonwealth of Virginia*, 328 U.S. 373, 377-78 (1946) (state legislation "invalid if it unduly burdens commerce in matters where uniformity is necessary in the constitutional sense of useful in accomplishing a permitted purpose"); *Armour & Co. v. Wantouk*, 323 U.S. 126, 129-30 (1944) (term "necessary" in the Fair Labor Standards Act, in context, means reasonably necessary to production, and not "indispensable," "essential," or "vital"); *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 413 (1819) (term "necessary" in the "necessary and proper" clause of the U.S. Constitution means "convenient, or useful," and does not limit congressional power to the "most direct and simple" means available). *See also, Independent Insurance Agents of America, Inc. v. Hawke*, 211 F.3d 638 (D.C. Cir. 2000) (term "necessary" in the National Bank Act means "convenient" or "useful").

[31] *See, e.g., Kirschbaum v. Arsenal Building Corp.*, 316 U.S. 517, 525-26 (1942) (term "necessary" in the Fair Labor Standards Act means "indispensable" and "essential"). The parties cite the recent *Fox* decision, 280 F.3d at 1049, for the proposition that the statutory phrase "necessary in the public interest" does not mean "merely consonant with [the public interest]". The Commission has filed a Petition for Rehearing or Rehearing *En Banc* with the District of Columbia Circuit seeking rehearing of the *Fox* Court's interpretation of the term "necessary" in the context of Section 202(h). *See Fox Television Stations, Inc., et al. v. FCC*, Nos. 00-1222, *et al.* (Petition for Rehearing or Rehearing *En Banc* of the Federal Communications Commission).

issue of whether the term "necessary" should be read in a more or less restrictive sense can or should be decided in the abstract. Rather, consistent with judicial precedent, the term is best construed in its statutory context.[32] Here, the statute provides that the exclusivity prohibition shall cease to be effective unless the Commission finds that "such prohibition continues to be necessary to preserve and protect competition and diversity in the distribution of video programming." Accordingly, we conclude that the exclusivity prohibition continues to be "necessary" if, in the absence of the prohibition, competition and diversity would not be preserved and protected.[33]

15. In applying the words of the statute to determine whether the exclusivity prohibition "continues to be necessary to preserve and protect competition and diversity in the distribution of video programming," we find guidance in the concerns Congress expressed in 1992. In the context of the market for the distribution of video programming as it existed in 1992, Congress determined that:

> The cable industry has become vertically integrated; cable operators and cable programmers often have common ownership. As a result, cable operators have the incentive and ability to favor their affiliated programmers.... Vertically integrated program suppliers also have the incentive and ability to favor their affiliated cable operators over nonaffiliated cable operators and program distributors using other technologies.[34]

16. Our analysis places substantial weight on whether, in the absence of the exclusivity prohibition, vertically integrated programmers would currently have the incentive and ability to favor their affiliated cable operators over nonaffiliated cable operators and program distributors using other technologies and, if they would, whether such behavior would result in a failure to protect and preserve competition and diversity in the distribution of video programming. AOLTW argues that the word "necessary" imposes an affirmative obligation on the Commission to justify retention of the exclusivity

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* Subsequent to the adoption of this *Order* but prior to its release, the D.C. Circuit granted the Commission's rehearing petition in *Fox* to the extent of deleting a paragraph in the opinion discussing the "necessary in the public interest" standard as used in Section 202(h) of the Telecommunications Act. The D.C. Circuit deleted the paragraph that had held the Commission, in interpreting the phrase "necessary in the public interest" under Section 202(h), "appears to have applied too low a standard." *Fox*, 280 F.3d at 1050. In modifying the opinion, the Court concluded that where the statutory interpretation was "unnecessary to the outcome of the case" and "might have had ill-considered implications for future cases" it is better to leave unresolved precisely what is meant by the "necessary in the public interest" phrase as used in Section 202(h). *Fox Television Stations, Inc. v. FCC*, Nos. 00-1222 (D.C. Cir. June 21, 2002), slip opin. at 5.

[32] *See, e.g., Conroy v. Aniskoff*, 507 U.S. 511, 515 (1993) (statute must be read as a whole, since the meaning of statutory language, plain or not, depends on context).

[33] Under conventional dictionary definitions, the terms "preserve" and "protect" mean "to keep safe from injury, harm, or destruction;" "to keep alive, intact, or free from decay;" "maintain;" "guard." *See, e.g.,* American Heritage Dictionary, Third Edition (1994); Webster's Ninth New Collegiate Dictionary (1987); Webster's Third New International Dictionary (1963).

[34] *See* 1992 Cable Act § 2(a)(5); *see also supra* n. 7 (discussing importance of vertically integrated programming to competitive MVPDs). For purposes of this analysis, we believe the ability to favor affiliated cable operators includes both having programming to which subscribers give high priority and the legal means of restricting distribution of that programming.

prohibition based on specific factual evidence in the record. We agree that Section 628(c)(5) creates a presumption that the rule will sunset unless the Commission finds that "such prohibition continues to be necessary to preserve and protect competition and diversity in the distribution of video programming." While specific factual evidence is necessary, it alone may not be sufficient to make that determination; we believe that the Commission may also rely on economic theory and its predictive judgment.[35]

IV. STATUS OF THE MVPD MARKET: 1992-2002

17. In undertaking our analysis, the Commission must examine the developments and changes in the MVPD marketplace over the last decade to determine whether, in light of these changes, the prohibition on exclusivity continues to be necessary to preserve and protect competition and diversity in the distribution of video programming. We will examine developments affecting the programming market before turning to the state of competition among MVPD providers.

18. The *Eighth Annual Report* indicates that in 2001, there were 294 satellite-delivered national programming networks.[36] Of those 294 networks, 104 networks, representing approximately 35 percent, were vertically integrated with at least one cable MSO.[37] At the time of the *First Report on Competition*, there were 107 satellite-delivered national programming services, of which 56 services, or 53 percent, were vertically integrated with at least one cable MSO.[38] The *First Report on Competition* indicates that at least ten different cable MSOs had attributable ownership interests in vertically integrated programming.[39] Moreover, four of the top ten cable MSOs – Tele-Communications, Inc. ("TCI") (largest MVPD), Time Warner (second largest MVPD), Cablevision (sixth largest MVPD) and Viacom (tenth largest MVPD)[40] – had an interest in at least 40 of the 56, or 71 percent, of the vertically integrated national satellite-delivered programming networks existing at that time.[41] As of the *Eighth Annual Report*, all vertically integrated programming is attributable to only five cable operators, Cox Communications, AOLTW, Comcast, Cablevision, and Liberty Media.[42] Four of these five are among the largest cable MSOs -- Cox Communications (fifth largest MSO), AOLTW (second largest MSO), Comcast (third largest MSO), and Cablevision (seventh largest MSO). One or more of these four MSOs has an interest in 52 of the 104 vertically integrated national satellite-delivered programming networks.[43]

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[35] *See FCC v. National Citizens Committee for Broadcasting*, 436 U.S. 775, 796-97 (1978).

[36] *Annual Status of Competition in the Market for the Delivery of Video Programming*, 17 FCC Rcd 1244, 1309 (2002) ("*Eighth Annual Report*").

[37] *Id.* The percentage of vertically integrated networks has remained the same in the years 2000 and 2001.

[38] *Implementation of Section 19 of the Cable Television Consumer Protection and Competition Act of 1992: Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 9 FCC Rcd 7442, 7589-92 (1994) ("*First Report on Competition*").

[39] *Id.* at 7596-98.

[40] *Id.* at 7587 (calculated taking into account 1994 mergers in the cable television industry).

[41] *Id.* at 7596-98.

[42] *Eighth Annual Report*, 17 FCC Rcd at 1310. On August 10, 2001, Liberty Media split off from AT&T Corporation and is now an independent company. However, through its ownership of Cablevision of Puerto Rico, it remains a small cable system owner. If Liberty Media were not considered as being vertically integrated, the ratio of vertically integrated channels would decrease from 35 percent in 2000 to 31 percent in 2001. *Id.* n. 511.

[43] *Id.* Liberty Media has the sole cable ownership interest in the remaining 52 vertically integrated satellite delivered national programming services.

Vertical integration is not only associated with the largest cable system operators, but also the programming networks with the largest number of subscribers. As stated in the *Eighth Annual Report*, nine of the top 20 satellite-delivered video programming networks (ranked by subscribership) are vertically integrated with a cable MSO. These programming services are TBS, Discovery Channel, TNT, USA Network, CNN, TLC, QVC, CNN Headline News and AMC.[44] In addition, seven out of the top 20 satellite-delivered video programming networks (ranked by prime time ratings) are vertically integrated with cable MSOs. These programming services are USA Network, TNT, Cartoon Network, TBS, Discovery Channel, TLC and Sci-Fi.[45]

19. We also note the growing importance of regional video programming services. The Commission did not start tracking regional video programming services until 1998.[46] At that time, there were 61 regional video programming services, 36 of which (59 percent) were affiliated with at least one cable MSO.[47] Twenty-seven of these regional video programming services were regional sports programming services, 22 of which (82 percent) were affiliated with at least one cable MSO.[48] According to the *Eighth Annual Report*, there are currently 80 regional programming services, 39 of which (49 percent) are affiliated with at least one cable MSO.[49] The majority of these services are currently satellite delivered.[50] Moreover, 28 of these regional video programming services are regional sports programming services, 24 of which (86 percent) are affiliated with at least one cable MSO.[51] The large majority of these regional sports services are currently satellite delivered.[52] Finally, we note that programmers continue to introduce new national and regional programming services – both vertically and non-vertically integrated. The *Eighth Annual Report* indicates that programmers announced 51 new programming services that plan to launch in the future.[53]

20. Turning to the status of MVPD competition over the last decade, we note that, in 1992, cable operators served more than 95 percent of all multichannel subscribers.[54] According to the *Eighth*

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[44] *Id.* at 1363. At the time of the *First Report on Competition*, 10 of the top 25 satellite delivered national programming services (ranked by subscribership) were vertically integrated with a cable MSO. *First Report on Competition*, 9 FCC Rcd at 7599.

[45] *Eighth Annual Report*, 17 FCC Rcd at 1364. At the time of the *First Report on Competition*, 12 of the top 15 satellite delivered national programming services (ranked by prime time ratings) were vertically integrated with a cable MSO. *First Report on Competition*, 9 FCC Rcd at 7600.

[46] *See Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 13 FCC Rcd 24284 (1998) ("*Fifth Annual Report*").

[47] *Id.* at 24439-41.

[48] *Id.*

[49] *Eighth Annual Report*, 17 FCC Rcd at 1354-56.

[50] *See* NCTA, *Cable Television Developments 2001* at 174-200 (at least 23 of 39 vertically integrated regional programming services are satellite delivered).

[51] *Eighth Annual Report,* 17 FCC Rcd at 1354-56.

[52] *See* NCTA, *Cable Television Developments 2001* at 174-200 (at least 21 of 24 vertically integrated regional sports programming services are satellite delivered).

[53] *Eighth Annual Report,* 17 FCC Rcd at 1357-58.

[54] *See Notice*, 16 FCC Rcd at 19078.

Annual Report, 78 percent of MVPD subscribers currently receive their video programming from a cable operator.[55] Between 1993 and 2001 cable subscribership increased by more than 11 million subscribers.[56] The number of cable subscribers continues to grow, reaching almost 69 million as of June 2001, up 1.9 percent from 67.7 million subscribers in June 2000.[57] Moreover, the four largest vertically integrated cable operators serve 34 percent of all MVPD subscribers.[58]

21. Over the last decade, there has been significant consolidation within the cable television industry. Consolidation within the cable industry continues today as cable operators acquire and trade systems. At the time of the *First Report on Competition*, the top four cable MSOs served 47 percent of all MVPD subscribers.[59] The degree of consolidation that has occurred over the past decade is perhaps best demonstrated by the fact that, although DIRECTV has grown to become the third largest MVPD with 11 percent of MVPD subscribers, the four largest cable MSOs now serve 48 percent of all MVPD subscribers.[60] The ten largest cable operators serve close to 87 percent of all U.S. cable subscribers.[61] By contrast, the *First Report on Competition* indicates that the ten largest cable operators served 63 percent of all U.S. cable subscribers in 1994.[62]

22. In addition, to increased concentration at the national level, system "swaps" and purchases over the course of the last decade have dramatically changed the shape of the cable television industry in terms of local or regional market "clusters" – *i.e.*, sets of commonly-owned cable systems within contiguous geographic market areas.[63] This change in ownership, from what has been described as a "collection of balkanized local systems," into a smaller number of larger more economically rationalized operations has been associated with system-owned local or regional programming.[64] As the pace of this trend was increasing, one analyst estimated that 20 percent of the nation's cable subscribers would change hands in 1995, and that nearly all of these transactions were driven by MSOs' interest in clustering systems.[65] The number of clusters of systems serving 100,000 or more subscribers increased from 88 at year-end 1993 to 108 at year-end 2000 with the number of clusters actually appearing to decrease as existing clusters merged with other existing clusters.[66] Some 34 of these systems had more

[55] *Eighth Annual Report*, 17 FCC Rcd at 1247.

[56] *Id.*; *see First Report on Competition*, 9 FCC Rcd at 7566.

[57] *Eighth Annual Report*, 17 FCC Rcd at 1247.

[58] *Id.* at 1341.

[59] *First Report on Competition*, 9 FCC Rcd at 7586.

[60] *Eighth Annual Report*, 17 FCC Rcd at 1341.

[61] *Id.* at 1252.

[62] *First Report on Competition*, 9 FCC Rcd at 7586.

[63] *Eighth Annual Report*, 17 FCC Rcd at 1304.

[64] *See e.g.*, Applications and Public Interest Statement in MM Docket No. 02-70 (AT&T Corp. and Comcast Corp. Transfer of Control Application) at 42 (filed February 28, 2002).

[65] Paul Kagen Assocs., Inc., *MSOs Swapping Their Way to ADI Dominance*, Cable TV Investor at 4 (Sept. 18, 1995).

[66] *See Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 11 FCC Rcd 2060, 2129 (1995) ("*Second Annual Report*"); *Eighth Annual Report*, 17 FCC Rcd at 1340.

than 500,000 subscribers by year-end 2000.[67] Close to 55 million of the nation's 69 million cable subscribers, or approximately 80 percent of cable subscribers, are served by systems that are a part of regional clusters.[68] For example, AT&T has large clusters in the Chicago, San Francisco/Oakland/San Jose, and Boston areas, with approximately five million subscribers in the three clusters.[69] In addition, Cablevision has a cluster of approximately 3 million subscribers in the New York metropolitan area.[70] Comcast's "Mid-Atlantic Super Cluster" with 4.4 million subscribers includes clusters in Pennsylvania, Maryland, Virginia, Washington, D.C., and Delaware.[71] To further illustrate the degree to which clustering has occurred over the last several years, at the end of 1994, 26 percent of Comcast subscribers were located in three regional clusters.[72] By the end of 2000, 92 percent of Comcast subscribers were located in six regional clusters.[73]

23. DBS providers, DIRECTV and EchoStar, have made significant progress as competitors to cable over the last decade, capturing 18 percent of MVPD subscribers.[74] As indicated in the *First Report on Competition*, DBS had approximately 40,000 subscribers in 1994.[75] Currently, DIRECTV (11 million subscribers) and EchoStar (7 million subscribers) are the third and seventh largest MVPDs respectively.[76] Since 1992, however, other competitors, such as MMDS, SMATV and HSD, have not fared as well. Competitors to cable, other than DBS providers, serve less than 4 percent of MVPD subscribers. Moreover, subscribership to these services has either declined or remained flat over the last several years.[77] At the time of the *First Report on Competition*, MMDS had 550,000 subscribers, SMATV had one million subscribers, and HSD had four million subscribers.[78] As of the *Eighth Annual Report*, MMDS had 700,000 subscribers (down from 1,100,000 subscribers in 1997), SMATV had 1,500,000 subscribers and HSD had 1 million subscribers.[79] In 1996, the Communications Act was amended to allow local exchange carriers to enter the video distribution market within their telephone service areas and it was widely anticipated that they would become significant competitors in this

[67] *See Eighth Annual Report*, 17 FCC Rcd at 1340.

[68] *Id.* at 1252.

[69] *Id.*

[70] See Kagen World Media, *Major Cable TV Systems/Clusters*, Broadband Cable Financial Databook 2001 at 36.

[71] *Eighth Annual Report*, 17 FCC Rcd at 1305.

[72] *See* Kagen Assoc., Inc., Cable TV Financial Databook at 14 38 (1995).

[73] *See* Kagen World Media, Broadband Cable Financial Databook at 19 36 (2000).

[74] *Eighth Annual Report*, 17 FCC Rcd at 1338.

[75] *First Report on Competition*, 9 FCC Rcd at 7475.

[76] *Eighth Annual Report*, 17 FCC Rcd at 1341.

[77] *Id.* at 1338.

[78] *First Report on Competition*, 9 FCC Rcd at 7480, 7482, 7488-89.

[79] *Eighth Annual Report*, 17 FCC Rcd at 1338.

market.[80] Although the Commission has certified a number of open video system operators, they collectively serve only approximately 60,000 subscribers nationwide.[81]

V. INCENTIVE AND ABILITY

24. In enacting the program access provisions of the 1992 Cable Act, Congress concluded that "[v]ertically integrated program suppliers also have the incentive and ability to favor their affiliated cable operators over nonaffiliated cable operators and programming distributors using other technologies."[82] We examine whether, 10 years after enactment of the prohibition on exclusivity vertically integrated programmers, in the absence of the prohibition, retain the incentive and ability to favor their cable affiliates over nonaffiliated cable operators and other competitive MVPDs to a degree that would fail to preserve and protect competition and diversity in the distribution of video programming. We will first discuss whether these programmers retain the ability to favor their cable affiliates over other MVPDs. That is, in the current market for video programming, does satellite-delivered vertically integrated programming remain programming that is necessary to the viability of competitive MVPDs and for which there are often no good substitutes? If we conclude that this remains true in the current market, vertically integrated programmers would have the ability to favor their affiliated cable operators over competitive MVPDs such that competition and diversity in the distribution of video programming would not be preserved and protected. Thereafter, we will discuss whether vertically integrated programmers retain the incentive to favor their cable affiliates.

25. At the outset of our analysis, we observe that, because the program access provisions, and the prohibition on exclusivity in particular, have been in effect since 1992, there is little direct evidence of anticompetitive foreclosure of access to vertically integrated programming upon which we can rely to determine whether or not vertically integrated program suppliers have the incentive and ability to favor their affiliated cable operators over competitive MVPDs such that competition and diversity in the distribution of video programming would not be preserved and protected. Accordingly, in determining whether to sunset the exclusivity prohibition, we will rely on the factual evidence available, economic theory and the Commission's predictive judgment of the direction in which the future public interest lies.[83] We further note that Congress acknowledged that the enforcement of the prohibition on exclusivity against all vertically integrated programmers may not always serve the public interest. Retention of the exclusivity prohibition does not foreclose all exclusive arrangements between vertically integrated programmers and cable operators.[84] In enacting the prohibition in 1992, Congress explicitly recognized the existence of such programming by creating the public interest exception to the prohibition.[85] Pursuant

[80] *See* 47 U.S.C. §§ 571 & 573; 47 C.F.R. §§ 76.1500-76.1514.

[81] *Eighth Annual Report*, 17 FCC Rcd at 1338.

[82] 1992 Cable Act § 2(a)(5). Congress also stated its policy "to ensure that cable television operators do not have undue market power vis-à-vis video programmers and consumers." 1992 Cable Act § 2(b)(5).

[83] *See FCC v. National Citizens Committee for Broadcasting*, 436 U.S. at 796-97.

[84] *See New England Cable News*, 9 FCC Rcd 3231 (1994) (granting petition for exclusivity); *Newschannel*, 10 FCC Rcd 691 (1994) (granting petition for exclusivity).

[85] Section 628(c)(4) sets forth five factors pursuant to which the Commission is to evaluate a petition for finding that a particular exclusive arrangement would serve the public interest. 47 U.S.C. § 548(c)(4). These factors are: (i) the effect of such exclusive contract on the development of competition in the local and national multichannel video programming distribution markets; (ii) the effect of such exclusive contract on competition from multichannel video programming distribution technologies other than cable; (iii) the effect of such exclusive contract on the attraction of

(continued....)

to this exception, when vertically integrated cable operators believe an exclusive arrangement will satisfy the public interest factors they may petition the Commission to approve such arrangements. For example, if a vertically integrated programmer contemplates the introduction of innovative services with limited or niche audiences and believes that these services will not be economically viable without a period during which they are offered on an exclusive basis, we encourage such programmer to petition the Commission to approve a period of exclusivity. Thus, in considering whether to retain the prohibition, our focus is appropriately directed toward whether access to vertically integrated programming in general is necessary to preserve and protect competition and diversity in the distribution of video programming.

A. Ability

26. In enacting the program access provisions of the 1992 Cable Act, Congress indicated that it deemed vertically integrated programming to be vital to the success of new entrants and competitive MVPDs. We consider whether developments in the ten years since the passage of the 1992 Cable Act diminish the importance of vertically integrated programming or affect the ability of vertically integrated programmers to favor their affiliated cable operators over other MVPDs such that competition and diversity in the distribution of video programming would not be preserved and protected.

27. Competitive MVPDs argue that they continue to face hurdles in seeking access to critical programming because cable operators continue to control essential video programming services.[86] In support, these commenters assert that more than one-third of all national programming networks are vertically integrated with at least one MSO.[87] In addition, these commenters note that, in many cases, more than one of the top five cable MSOs holds an attributable interest in vertically integrated services, nine of the largest 20 video programming services in terms of subscribership are vertically integrated with cable MSOs,[88] and 11 of the top 20 services in terms of prime time ratings are vertically integrated.[89]

28. Competitive MVPDs agree that access to programming is a key component to successful implementation of competitive services.[90] These commenters argue that they must have access to what they refer to as "marquee" or "must have" vertically integrated programming, such as CNN, TNT, HBO,

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capital investment in the production and distribution of new satellite cable programming; (iv) the effect of such exclusive contract on diversity of programming in the multichannel video programming distribution market; and (v) the duration of the exclusive contract. *Id.*; *see also* 47 C.F.R. § 76.1002(c)(4).

[86] BSPA Comments at 8; IMMC Comments at 5-6; ACA Reply Comments at 3.

[87] BSPA Comments at 8; NRTC Comments at 5, each citing *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 16 FCC Rcd 6005, 6078 (2001) ("*Seventh Annual Report*"). In referring to current marketplace conditions, competitive MVPDs generally cite to the *Seventh Annual Report*.

[88] BSPA Comments at 8; NRTC Comments at 5, each citing *Seventh Annual Report*, 16 FCC Rcd at 6079, 6134.

[89] BSPA Comments at 8; IMCC Comments at 5; NRTC Comments at 5. These commenters note that these vertically integrated "marquee" networks include the USA Network (AT&T), TBS (AOLTW), TNT (AOLTW), the Cartoon Network (AOLTW), TLC (AT&T, Cox), the Sci Fi Channel (AT&T), Comedy Central (AOLTW) Court TV (AT&T, AOLTW), CNN (AOLTW), E! (Comcast, AT&T) and APL (AT&T, Cox); *see also Seventh Annual Report*, 16 FCC Rcd at 6079, 6139.

[90] BSPA Comments at 11; Carolina Broadband Comments at 4; Joint Comments at 4.

Discovery and others.[91] APPA asserts that denial of even a handful of "must have" channels through use of exclusive contracts can destroy a new provider's ability to compete effectively against an entrenched incumbent.[92] The Joint Commenters argue that the mere prospect that high-profile programming services might be taken exclusively by the largest MSOs is more than enough to sour investors on terrestrial competition and chill funding of terrestrial overbuild (wired or wireless) technologies.[93] ACA argues that without enforceable access rights to vertically integrated programming, small cable systems risk losing between 30 to 42 percent of satellite programming. ACA contends that no supportable argument can be made that such a reduction in accessible satellite programming preserves and protects program diversity in smaller markets.[94] EchoStar argues that if competitive MVPDs are denied access to desirable cable networks such as HBO or CNN, these MVPDs cannot simply go to the video programming market and obtain substitute programming that will prevent consumers from migrating to cable to see their favorite programs.[95] EchoStar argues that this action may be feasible in a hypothetical perfectly competitive market, but not in the real world of video distribution. EchoStar argues that video programming is not a fungible good; it is a highly differentiated product for which, in many cases, there simply are no good substitutes available.[96]

29. Competitive MVPDs are particularly concerned about the loss of national and regional sports programming absent the Section 628(c)(2)(D) prohibition.[97] These commenters argue that access to sports programming is necessary in order to provide a viable multichannel video programming package.[98] Competitive MVPDs argue that regional or local sports programming presents a special problem because it is unique programming. Commenters argue that local sports cannot be duplicated by competing MVPDs or acquired from alternative sources, even if the cost of doing so were not an issue.[99] RCN asserts that for the fan who wishes to see a Washington Redskins game, the alternative of a local NBA or NHL game, or even a distant NFL contest, is not an acceptable substitute.[100] RCN and others argue that the cable industry has adopted ownership or control of local sports programming as a device to capture or assure dominance in local markets. These commenters contend that because local sports programming is so highly desired by subscribers, its unavailability imposes an unusually significant competitive harm.[101]

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[91] IMCC Comments at 5; EchoStar Comments at 9; ACA Reply Comments at 3; CNI Wireless Reply Comments at 1.

[92] APPA Comments at 4.

[93] Joint Comments at 16.

[94] ACA Reply Comments at 3.

[95] EchoStar Reply Comments at 20.

[96] *Id.*

[97] Joint Comments at 11; BSPA Comments at 11; RCN Comments at 14; Gemini Comments at 5; Seren Comments at 10; IMCC Comments at 4.

[98] Joint Comments at 11; BSPA Comments at 11; RCN Comments at 14; Gemini Comments at 5; Seren Comments at 10; IMCC Comments at 4.

[99] Seren Comments at 11; RCN Comments at 14.

[100] RCN Comments at 14.

[101] RCN Comments at 13; Gemini Comments at 13; Seren Comments at 11.

30. Cable MSO commenters argue that over the course of a decade, the number of national video programming services competing for viewers has more than tripled, while the percentage of such services that are vertically integrated with a cable company has dropped by half.[102] AOLTW contends that given the plethora of programming available today, particularly the wide variety of popular program services available from non-vertically integrated providers, the exclusivity restriction cannot be retained.[103] Cablevision argues that, in contrast to ten years ago, there are ample substitutes and competing programming for most of the major, national video programming networks. Citing several examples, Cablevision asserts that there are multiple news channels (CNN, Fox News, MSNBC), children's channels (Nickelodeon, Disney, Toon Disney, Cartoon Network), national sports networks (ESPN and Fox Sports - as well as sports available on TNT and TBS), and music channels (VH-1, MTV, CMT, Much Music).[104]

31. NCTA deems significant that over the past decade the percentage of vertically integrated programming has declined while there has been an increase in the number of program services in which cable operators have no ownership interest.[105] Cable MSOs assert that the entry of new independent programming into the MVPD marketplace over the past decade has sufficiently weakened their ability to effectively foreclose access to enough programming to have anticompetitive effects. Additionally, NCTA asserts that Congress worried that cable operators controlled not just a relatively large number of satellite-delivered program networks, but also the most popular networks.[106] In contrast, NCTA argues that today the number of popular vertically-integrated programming services has been substantially diluted.

32. We agree with competitive MVPDs that access to vertically integrated programming continues to be necessary in order for these MVPDs to remain viable in the marketplace. We acknowledge the arguments of cable MSOs that the amount and diversity of programming available for distribution by MVPDs has substantially increased since the enactment of the exclusivity prohibition, while the percentage of vertically integrated programming has declined. However, the most recent statistics on vertically integrated programming continue to demonstrate the importance of this programming. Perhaps most significant is that vertically integrated content constitutes 35 percent of the most popularly rated satellite-delivered prime time programming and 45 percent of the most-subscribed-to programming. Moreover, the increased prominence of vertically integrated regional programming services, particularly sought-after and non-duplicable regional sports programming, strengthens the overall importance of vertically integrated programming to competitive MVPDs. In addition, some separate subscription premium networks, such as HBO and Cinemax, are also vertically integrated. Even though they are not among the top programming services in subscribership, they make an important contribution to an MVPD's revenue and profits. Various commenters cite HBO as "must have" programming, the absence of which could harm an MVPD. Failure to secure even a portion of vertically integrated programming would put a nonaffiliated cable operator or competitive MVPD at a significant disadvantage *vis-a-vis* a competitor with access to such programming.

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[102] AOLTW Comments at 18; Cablevision Comments at 35; Comcast Comments at 8.

[103] AOLTW Comments at 18.

[104] Cablevision Comments at 36.

[105] NCTA Comments at 11.

[106] *Id.* at 12.

33. Cable MSOs argue that, given the plethora of cable channels available, substitute programming -- vertically integrated or otherwise -- will be available to fill the niche left by vertically integrated programming subject to an exclusive arrangement. Doubtless, this would be true in some instances, but certainly not in every, nor perhaps in a majority of cases. As expressed in many comments, cable programming -- be it news, drama, sports, music, or children's programming -- is not akin to so many widgets. Cable programmers strive to build an identity for their channel that is recognizable and sought-after by viewers. For example, when an MVPD loses access to a popular national news channel, there is little competitive solace that there is a music channel or children's programming channel to replace it. Even when there is another news channel available, an MVPD may not be made whole because viewers desire the programming and personalities packaged by the unavailable news channel. Moreover, even if an acceptable substitute is found, the competitive MVPD is still harmed because its competitor can likely offer to subscribers both the unavailable programming and its substitute. Thus, there is a continuum of vertically integrated programming, ranging from services for which there may be substitutes (the absence of which from a rival MVPD's program lineup would have little impact), to those for which there are imperfect substitutes, to those for which there are no close substitutes at all (the absence of which from a rival MVPD's program lineup would have a substantial negative impact). Despite the progress that has been made in the 10 years since enactment of the 1992 Act, a considerable amount of vertically integrated programming in the marketplace today remains "must have" programming to most MVPD subscribers. We agree with the competitive MVPDs' assertion that if they were to be deprived of only some of this "must have" programming, their ability to retain subscribers would be jeopardized.[107]

34. The more that the programming package offered by a competitive MVPD lacks the "must have" programming that is a part of the incumbent cable operator's programming package (*i.e.*, the new entrant offers a similar, but differentiated product) the less attractive the competitive MVPD's programming package will be to subscribers. Thus, we find that an MVPD's ability to provide a service that is competitive with the incumbent cable operator is significantly harmed if the MVPD is denied access to popular, vertically integrated programming for which no good substitute exists. We further find that, given the unique nature of cable programming, there frequently are not good substitutes available for vertically integrated programming services, including services that are considered "must have" programming by competitive MVPDs and the subscribers they serve, such as regional news and sports programming. Accordingly, we conclude that vertically integrated programmers continue to have the ability to favor their affiliated cable operators over competitive MVPDs in a manner that would competitively harm such MVPDs in the absence of the prohibition.

B. Incentive

35. Determining whether vertically integrated programmers have the incentive to favor their affiliated cable operators over competitive MVPDs such that competition and diversity in the distribution

[107] DIRECTV and EchoStar assert that their significantly lower subscribership in Philadelphia as compared to other large cities is directly attributable to their inability to access Comcast SportsNet. *Economic Assessment* at 24. DBS subscribership in Philadelphia is 3.9 percent, or less than half the 9.3 percent weighted average of the top 20 largest cities (excluding Philadelphia). *Id.* at 22-24. We note that, in other contexts, parties have challenged EchoStar's DBS penetration figures for the Philadelphia market (asserting that it ranges from 5.3 percent to 8.5 percent) using different reference sources than the *Economic Assessment*. *See Applications for Consent to the Transfer of Control of Licenses*, MB Docket No. 02-70 (AT&T Corp/Comcast Corporation Reply to Comments and Petitions to Deny Applications for Consent to Transfer Control at 104). Using either figure, it is apparent that DBS penetration in Philadelphia is well below the 18 percent national penetration rate.

of video programming would not be preserved and protected requires us to examine two factors. First, we must determine whether cable operators, through the number of subscribers they serve and their affiliations with satellite programmers, continue to have market dominance of sufficient magnitude that, in the absence of the prohibition, they would be able to act in an anticompetitive manner. Next we must consider whether there continues to be an economic rationale for vertically integrated programmers to engage in exclusive agreements with cable operators that will cause such anticompetitive harms.

36. To help understand the analysis that follows, we explain briefly how a vertically integrated cable programmer might attempt to harm rival MVPDs. The programmer could sign exclusive contracts for the distribution of its program networks for which good substitutes are not available. The programmer would likely contract with distributors (e.g., cable systems) in markets where it does not itself own cable systems, so as not to harm its distribution business. However, its programming business likely would suffer because the exclusive arrangements would reduce the number of platforms distributing the program networks and thereby the total number of subscribers to the networks. In the long term, however, the vertically integrated cable programmer can gain from the increased subscription to its cable distribution service that occurs when customers search for alternatives to the rival distribution systems that are precluded from carrying the popular programming networks in question. Thus, the exclusive distribution contract can be viewed as a kind of "investment," in which an initial loss of profits from programming is incurred in order to achieve higher profits later from cable distribution.

37. An investment of this sort will tend to be most profitable when the costs of the investment are low and its benefits are high. The costs tend to be low when the initial loss in programming revenue is low (because, for example, the excluded platforms serve relatively fewer customers or the distributors that obtain exclusive rights to the program networks are willing to pay a large premium for this privilege). The benefits of the investment tend to be high when the vertically integrated cable programmer ultimately expects to serve a large number of subscribers, and will be able to charge them substantially more for cable distribution service than it could if it faced a strong rival distribution platform.[108]

38. The number of subscribers that a vertically integrated cable programmer serves is of particular importance in calculating the benefits of withholding programming from rival MVPDs. The larger the number of subscribers controlled by the vertically integrated cable programmer the larger the benefits of withholding that accrue to that programmer. Other things being equal, then, as the number of subscribers rises, so does the likelihood that withholding would be profitable.[109]

39. The same analysis applies to regional programming and cable system clusters. Consider a vertically integrated regional programming service for which 100 percent of demand comes from viewers in the region, and suppose that one MSO owns all of the cable systems in that region. If a

[108] Notice that a cable operator may gain by weakening a current or potential rival even in markets that the cable operator itself does not serve, particularly when the rival distributor's operations exhibit substantial scale economies. Reducing the rival's customer base in other markets would raise the rival's average cost of serving customers in the cable operator's own market(s), and thereby reduce the rival's competitive strength. DBS distributors have high fixed costs and a national infrastructure. If a vertically integrated cable programmer could, by withholding programming from the DBS operator, reduce the scale of DBS operations across the country, the DBS operator might become a less formidable competitor in the operator's own markets.

[109] If a program service is owned by more than one cable operator, then the magnitude of benefits captured by owners and, hence, the likelihood of withholding, generally increases with the total number of subscribers controlled by the owners.

programmer affiliated with that cable operator were to withhold programming from rival MVPDs, 100 percent of the benefits would accrue to that operator. Thus, even if the regional vertically integrated cable programmer has fewer than 100 percent of MVPD households in the region, and hence incurs costs by distributing programming exclusively via cable, the fact that the operator reaps 100 percent of the benefits may make the withholding profitable.

40. In concluding in 1992 that vertically integrated programmers had the incentive to favor their cable affiliates, Congress stressed the market dominance that cable operators exercised in the distribution of video programming.[110] Accordingly, we examine the changes that have occurred in the intervening years and how these changes may have impacted this incentive. An important component of this analysis will be an evaluation of the current status of competition in the market for the distribution of video programming. AOLTW and other cable MSO commenters assert that the exclusivity prohibition should sunset in light of indisputable competitive developments in the MVPD market.[111] NCTA notes that in 1992, multichannel competitors to cable comprised about one million C-band satellite dish customers, about 300,000 MMDS customers, and 1.3 million overbuild customers.[112] NCTA states that the situation had not changed materially by the time the *First Report on Competition* was issued two years after the 1992 Cable Act was passed.[113] NCTA argues that today cable competes with these providers and a wide range of others.[114] NCTA asserts that customers have increasingly subscribed to these alternatives, with non-cable subscribership growing nearly ten-fold from an aggregate of 2,330,000 non-cable MVPD customers in December 1992 to more than 20,876,000 in September 2001.[115] Cable MSO commenters argue that, in contrast, cable's share of total MVPD customers has dropped from 95% in 1992 to 77% in 2001.[116] Cable MSO commenters assert that their market share has dropped because the MVPD marketplace has significantly developed to include real competition from DBS, SMATV providers, OVS operators, cable overbuilders, incumbent telephone companies, municipalities and utilities.[117] Cable MSO commenters place particular emphasis on competition received from national MVPD competitors such as DBS and from local terrestrial MVPD competitors, such as RCN, Wide Open West, Western Integrated Networks and Knology.[118]

41. Cable MSO commenters unanimously agree that DBS in particular has proven itself to be a competitive substitute for cable.[119] Today, NCTA argues that the technology, program selection, and

[110] 1992 Cable Act § (2)(a)(3) ("cable television has become a dominant nationwide video medium").

[111] AOLTW Comments at 7; AT&T Comments at 16; Cablevision Comments at 22; Comcast Comments at 4; NCTA Comments at 4.

[112] NCTA Comments at 5, citing *First Report on Competition*, 9 FCC Rcd. At 7540 (1994).

[113] *Id.*

[114] *Id.* In referring to current marketplace conditions, NCTA and cable MSOs generally cite to the *Seventh Annual Report*, 16 FCC Rcd 6005 (2001).

[115] *Id.* at 6.

[116] Cablevision Comments at 22; AOLTW Reply Comments at 7.

[117] AT&T Comments at 19; Cablevision Comments at 22; AOLTW Reply Comments at 4.

[118] Comcast Comments at 4; NCTA Comments at 6-7; Cablevision Reply Comments at 2.

[119] NCTA Comments at 7; AOLTW Comments at 7; AT&T Comments at 18; Cablevision Comments at 22; Comcast Comments at 5.

market status of DBS have been completely transformed.[120] AT&T and others note that DIRECTV and EchoStar are now the third and sixth largest MVPDs respectively and that they are larger than the majority of cable MSOs.[121] Cable MSO commenters assert that if the planned merger between DIRECTV and EchoStar is approved and consummated, the combined company would have more subscribers than any other MVPD.[122] AOLTW and others note that DBS providers' share of total MVPD subscribers has grown to 18 percent.[123] NCTA reports that the total number of DBS subscribers jumped from 14 million to 16.73 million between September 2000 and September 2001 and this represents a 19 percent annual growth rate.[124] Cable MSO commenters also contend that the ability of DBS to continue to attract new subscribers has only been enhanced by the enactment of the Satellite Home Viewer Improvement Act of 1999 ("SHVIA"), which enabled DBS to offer local broadcast signals.[125]

42. Competitive MVPDs argue that the Commission should not overemphasize the growth of DBS in assessing the competitive landscape.[126] The Joint Commenters argue that the fact that the market for multichannel video service has evolved from a cable monopoly to a market dominated by cable and DBS is hardly persuasive evidence that the market is fully competitive.[127] ACA argues that small cable companies and other competitors are at risk if the Commission accepts the argument that the exclusivity prohibition is no longer required due to competition from DBS.[128]

43. Competitive MVPDs assert that the transition to a competitive marketplace that Congress and the Commission envisioned ten years ago has yet to occur.[129] CBC argues that while the video distribution market is somewhat more competitive than it was in 1992, the market has not yet reached a level of sustainable competition such that the exclusivity prohibition should be allowed to sunset.[130] Competitive MVPD commenters argue that cable remains the dominant MVPD, accounting for approximately 80 percent of the MVPD market.[131] Moreover, competitive MVPDs also note that the top ten cable MSOs serve nearly 90 percent of all cable subscribers.[132]

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[120] NCTA Comments at 7.

[121] AT&T Comments at 18; NCTA Comments at 7; AOLTW Comments at 7.

[122] AT&T Comments at 18; Comcast Comments at 6; NCTA Comments at 7.

[123] AOLTW Comments at 8; Cablevision Comments at 22.

[124] NCTA Comments at 7.

[125] AOLTW Comments at 9; NCTA Comments at 8.

[126] CBC Reply Comments at 3; Media Access Project *et al.* Reply Comments at 5.

[127] Joint Comments at 21.

[128] ACA Comments at 2.

[129] APPA Comments at 4-5; WSNet Comments at 3; BSPA Reply Comments at 2.

[130] CBC Comments at 6.

[131] *Id.* at 6; RCN Comments at 19; Joint Comments at 6; EchoStar Reply Comments at 7.

[132] Joint Comments at 6; WSNet Comments at 3; IMCC Comments at 3; *see also Seventh Annual Report*, 16 FCC Rcd at 6013, 6074.

44. In the *Notice*, the Commission sought comment on the degree to which clustering and consolidation should inform our decision with regard to the sunset of the exclusivity prohibition.[133] Competitive MVPDs argue that cable operator market power is evidenced by the increasing industry consolidation that has taken place over the last several years.[134] These commenters assert that horizontal consolidation in the cable industry increases the incentives for anticompetitive foreclosure of access to vertically integrated programming.[135] Competitive MVPDs also contend that the effects of horizontal consolidation on nondiscriminatory access to key programming is only exacerbated by the phenomenon of "clustering" which has also increased in recent years. As WSNet observes, MSOs have managed, either through the sale or swap of territories, to cluster large numbers of cable communities so that various companies serve contiguous portions of the country.[136] The Joint Commenters assert that cable programmers once had significant opportunities to sell their programming to multiple cable operators in a local market. The Joint Commenters contend that today many programmers are forced to deal with a single cable operator which has consolidated previously independent systems into a cluster so that it controls a majority of the market's subscribers. Accordingly, the Joint Commenters argue that this exposes terrestrial competitors to a risk that programmers will accede to cable's dominance over distribution and refuse to sell their programming to alternative MVPDs that don't serve a critical mass of subscribers in the relevant geographic market.[137]

45. It is evident that competition in the MVPD market has increased in some respects since 1992. We are not persuaded by the arguments presented by cable MSOs, however, that market conditions have changed so fundamentally, and competition in the distribution of video programming is now so robust, that vertically integrated programmers no longer have the incentive to favor affiliated cable operators such that, in the absence of the prohibition, competition and diversity in the distribution of video programming would not be preserved and protected.[138] The *Eighth Annual Report* indicates that the

[133] *Notice*, 16 FCC Rcd at 19078. In *Time Warner Entertainment Co. v. FCC*, 240 F.3d 1126 (D.C. Cir. 2001), the United States Court of Appeals for the D.C. Circuit reviewed the Commission's cable television horizontal and vertical ownership limits and attribution benchmarks, and reversed and remanded the rules. The Commission's horizontal limit bars a cable operator from having an attributable interest in more than 30 percent of nationwide subscribership of multichannel video programming, and the vertical limit bars a cable operator from carrying attributable programming on more than 40 percent of channels up to 75 channels of capacity. The Commission has undertaken a proceeding to respond to the D.C. Circuit's concerns regarding the cable ownership rules. *See Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992: The Commission's Cable Horizontal and Vertical Ownership Limits and Rules*, 16 FCC Rcd 17312 (2001).

[134] Carolina Broadband Comments at 2; Gemini Networks Comments at 3; RICA Comments at 4.

[135] IMCC Comments at 3; Carolina Broadband Comments at 3; DIRECTV Reply Comments at 8.

[136] WSNet Comments at 4.

[137] Joint Comments at 6. WSNet also contends that while clustering purportedly is more efficient, these efficiencies have not been passed on to cable customers who typically pay more in clustered areas. WSNet Comments at 4. RCN observes that while it may prove difficult to measure market power, certainly one crucial indicator of market power is the ability to raise rates and that the cable industry has, and continues to, raise rates faster than inflation. RCN Comments at 20-21.

[138] Further, we reject AOLTW's argument that First Amendment concerns mandate sunset of the exclusivity prohibition. AOLTW Reply, at 3. The exclusivity prohibition was previously upheld in the face of a First Amendment challenge. *Time Warner Entertainment Co. L.P. v. FCC*, 93 F.3d 957 (D.C. Cir. 1996). Moreover, we do not find persuasive AOLTW's contention that commenters favoring retention fail to provide "substantial evidence" that sunset of the prohibition would significantly hamper competition and/or diversity, as required under the intermediate scrutiny test. *Id.*, *citing Time Warner Entertainment Co. L.P.*, 93 F.3d at 979 (upholding section

(continued....)

market for the delivery of video programming to households continues to be highly concentrated and characterized by substantial barriers to entry.[139] Among these barriers is the strategic behavior by incumbent cable operators designed to raise rivals' costs, *e.g.*, limiting the availability to rivals of certain popular programming and equipment.[140] In addition, although competitive satellite alternatives to the incumbent wireline MVPDs are developing and attracting an increasing number of MVPD subscribers, most consumers have limited choices among video distributors. Only a small percentage of consumers have a second wireline alternative, such as an open video system or overbuild cable system.[141] Moreover, among the several wireless technologies used to provide video programming service, DBS is the only wireless technology available to a majority of subscribers nationwide. Homes are generally passed by only one wireline cable operator and the two major DBS providers, DIRECTV and EchoStar.[142] Of the 33,000 cable community units nationwide, only 419, or approximately one percent, have been certified as having effective competition as a result of consumers having a choice of more than one MVPD.[143]

46. In 1992, cable operators served more than 95 percent of all multichannel subscribers.[144] Nearly ten years later, cable operators still control a formidable share of the market with 78 percent of MVPD subscribers receiving their video programming from a cable operator.[145] DBS providers have made significant progress as competitors to cable, capturing 18 percent of MVPD subscribers, due in part to authority granted by SHVIA to DBS operators to distribute local broadcast television stations in their local markets.[146] Indeed, we believe that the marked growth of DBS since the enactment of SHVIA provides an informative example of the impact on competition in the distribution of video programming when marketplace participants gain access to valuable programming to which they were previously denied. Other competitors, such as MMDS, open video systems, SMATV and HSD, however, have not fared as well, serving less than 4 percent of MVPD subscribers. Subscribership to these services has either declined or remained flat over the last several years.[147] Moreover, we note that the strong overbuild

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628's prohibition on exclusive contracts using intermediate scrutiny test). To the contrary, as described herein, we believe the record fully supports our finding that vertically integrated programming continues to be necessary in order for competitive MVPDs to remain viable in the marketplace and diversity in the distribution of video programming preserved and protected. Likewise, we reject AOLTW's argument that existing antitrust laws provide a remedial approach that is "less restrictive" than the exclusivity prohibition and therefore retention of the prohibition cannot meet the intermediate scrutiny test's "narrowly tailoring" requirement. By passing Section 628, Congress already determined that antitrust laws were not a viable alternative for achieving the government's goals in this instance.

[139] *Eighth Annual Report,* 17 FCC Rcd at 1298.

[140] *Id.*

[141] *Id.*

[142] *Id.* We note that although DBS services are presumed to be technically available nationwide, they may not actually be available to many subscribers in multiple dwelling units or in households that are not within the line-of-sight of a DBS signal. *Id.* at 1299.

[143] *Id.*

[144] *See Notice*, 16 FCC Rcd at 19078.

[145] *Eighth Annual Report*, 17 FCC Rcd at 1247.

[146] *See id.* at 1273-74.

[147] *Id.* at 1338.

competition from local exchange carriers and others that Congress anticipated as a result of the 1996 amendments to the Communications Act has, as yet, failed to develop.

47. The incentive to favor affiliated cable operators over nonaffiliated MVPDs, specifically with respect to regional programming, is also strengthened by cable system clustering. A significant portion of cable operator system acquisition and trading activity is devoted to creating and expanding clusters. Today, close to 55 million of the nation's 69 million cable subscribers, or approximately 80 percent of cable subscribers, are served by systems that are a part of regional clusters.[148] One of the stated reasons for pursuing clusters of cable systems is the ability to "offer more local and regional programming for consumers."[149] We have already noted that regional programming services, the majority of which are satellite delivered, are significantly more vertically integrated than national programming services.[150] Moreover, 86 percent of "must have" regional sports programming is vertically integrated.[151] We believe that clustering, accompanied by an increase in vertically integrated regional programming networks affiliated with cable MSOs that control system clusters, will increase the incentive of cable operators to practice anticompetitive foreclosure of access to vertically integrated programming. All things considered, the evidence submitted in this proceeding indicates that cable operators continue to dominate the market for distribution of multichannel video programming with regard to both national and regional programming.

48. Having concluded that cable operators dominate the market for the delivery of video programming in a manner that would allow them to act in an anticompetitive manner, we next address whether vertically integrated programmers continue to have an economic rationale to engage in such anticompetitive behavior (*i.e.*, to favor their cable operator affiliates over other competitive MVPDs). It is important to examine whether vertically integrated programmers retain an economic rationale to favor their cable operator affiliates over other competitive MVPDs because this will determine whether there is a significant potential for denial of access to vertically integrated programming in the absence of regulation.

49. Cable MSOs argue that despite the concerns of competitive MVPDs, there is no real threat of a wide-scale withdrawal of the vertically integrated programming that non-cable customers enjoy today.[152] AT&T asserts that the suggestion that cable MSOs might enter into exclusive contracts as some sort of predatory investment is implausible.[153] Cable MSOs argue that even absent a statutory ban on exclusivity, strong incentives remain to provide programming to all MVPDs. These commenters contend that virtually all programmers rely on subscription revenues to support their programming efforts and that advertiser-supported cable networks compete vigorously for access to as many households as possible in order to maximize their advertising sales.[154] NCTA cautions, however, that in order to differentiate a cable system from its competitors, new programming created only for cable may develop if

[148] *Id.* at 1252 & 1255.

[149] *Id.* at 1304-05.

[150] *See supra* ¶¶ 18-19 (35 percent of national programming services are vertically integrated while 49 percent regional programming services are vertically integrated).

[151] *See supra* ¶ 19.

[152] NCTA Comments at 14; AT&T Comments at 24; Cablevision Comments at 29.

[153] AT&T Comments at 24.

[154] NCTA Comments at 14; Cablevision Comments at 29.

the exclusivity prohibition were to sunset, but such a development would increase, not decrease, competition and diversity.[155] AT&T adds that in the unlikely event that harm could be shown from exclusive arrangements, redress is readily available to injured competitors under the antitrust laws.[156] In addition, in urging the Commission to sunset the exclusivity prohibition, cable MSOs assert that, in virtually every segment of the American economy other than vertically integrated programming, the opportunity to enter into exclusive contracts is the norm, rather than the exception.[157]

50. ACA argues that, for its small cable operator members, the threat is not wide scale withdrawal, but small scale withdrawal of programming.[158] ACA argues that denial of access to core satellite programming in just a few franchise areas would cripple a small cable system.[159] Similarly, BELD challenges AT&T's assertion that it is implausible that cable MSOs might enter into exclusive contracts as a predatory investment. BELD refers to AT&T's refusal to allow New England Cable News ("NECN") to distribute its service to BELD and states that this plainly contradicts AT&T's statement. BELD notes that NECN, and its owner at the time, Continental Cablevision, once benefited from a waiver of the exclusivity prohibition when a claim was made that exclusivity was necessary for the survival of the fledgling service.[160] Shortly after receiving its exclusivity waiver, BELD notes that NECN shifted to terrestrial distribution. BELD states that NECN has been on the air for over eight years and is a well-established service. Nonetheless, while BELD states that it wants to carry NECN on its cable system and has offered to pay NECN's monthly license fees for its service, AT&T has refused to allow carriage. BELD notes that while AT&T does not have to grant BELD carriage because NECN is now terrestrially delivered, BELD contends that the sole reason for such exclusivity is to maximize AT&T's predatory investment.[161]

51. Competitive MVPD commenters also argue that the antitrust laws are not adequate to protect the public from the adverse effects of program exclusivity.[162] Northpoint contends that it cannot be argued that the antitrust laws, which provide competitors with an after-the-fact remedy for anti-competitive conduct, can supplement sound Commission policies designed to afford competitors with some semblance of a level playing field.[163] Northpoint argues that new entrants face immense hurdles in the competitive market and protracted antitrust litigation would be yet another unnecessary and costly hurdle.[164] Competitive commenters argue that the exclusivity prohibition still serves an important purpose and continues to be necessary. In that regard, IMCC contends that the fact that exclusive programming

[155] NCTA Comments at 15.

[156] AT&T Comments at 24.

[157] Cablevision Comments at 2; AT&T Comments at 9.

[158] ACA Reply Comments at 4.

[159] *Id.*

[160] BELD Broadband Reply Comments at 2; *see also In the Matter of New England Cable News*, 9 FCC Rcd 3231 (1994).

[161] BELD Broadband Reply Comments at 2.

[162] RCN Reply Comments at 10; Northpoint Reply Comments at 13; DIRECTV Reply Comments at 5.

[163] Northpoint Reply Comments at 13.

[164] *Id.*

contracts do not currently appear to present a significant problem in competitive access is evidence that Section 628(c)(2)(D) has worked and should remain in place.[165]

52. Competitive MVPDs argue that in the absence of restrictions on exclusive arrangements between cable operators and vertically integrated programmers, incumbent cable interests will be likely to withhold access to programming that is vital for competing MVPDs to succeed.[166] These commenters argue that cable MSOs still have the incentive to use control over program packages to stymie the development of MVPDs just as they did when Congress enacted the exclusivity prohibition ten years ago.[167] EchoStar points out that in most cases, the principal interest of the programmer will be in reaching as many viewers as possible through as many outlets as possible. However, in the case of vertically integrated programmers, EchoStar contends that an additional factor enters the equation. EchoStar asserts that vertically integrated providers have the ability to forego the short-term revenues that could be secured by licensing their programming to other MVPDs and instead choose to funnel programming only to cable outlets, thereby protecting their market power, *i.e*, their ability to charge consumers what they choose without concern that consumers will switch to another competitor.[168] In support, EchoStar and DIRECTV have submitted an economic analysis that states that the costs of foreclosure are the foregone revenue from all other MVPD outlets.[169] This theory suggests that the benefit of foreclosing access to programming is that it increases relative demand for the cable package because the package would be the only avenue to view exclusive programming. The gains from foreclosure would be reflected in the potential increase in the prices charged by the cable system and in the number of subscribers that shift from alternatives to the vertically integrated cable system in order to view the foreclosed programming, or that remain with the cable system when they would have otherwise moved.[170]

53. Cable's dominant market position coupled with the continuing need for access to "must have" vertically integrated programming by competitive MVPDs, in many cases, imparts an incentive for cable MSOs to exert anticompetitive control over vertically integrated programming services. We agree that in many instances, the economic incentive of vertically integrated programmers will be to make their programming available to as many MVPD outlets as possible. However, there will likely also be many instances in which the economic incentive will be to offer programming on an exclusive basis to a subset of MVPDs. Moreover, as argued by EchoStar and DIRECTV, this need not be financially disadvantageous to the vertically integrated programmer.[171] As discussed above, cable operators dominate the market for the distribution of video programming serving 78 percent of all MVPD subscribers. This suggests that the costs of withholding programming from non-cable MVPDs (*i.e.*, the revenues foregone by not selling the programming to non-cable MVPDs) remain relatively low. A "cable-only" distribution

[165] IMCC Comments at 10.

[166] DIRECTV Reply Comments at 8; BSPA Reply Comments at 16; Verizon Reply Comments at 1.

[167] BSPA Reply Comments at 16; Verizon Reply Comments at 1.

[168] EchoStar Comments at 17.

[169] *See "An Economic Assessment of the Exclusive Contract Prohibition Between Vertically Integrated Cable Operators and Programmers"* at 18 (Jonathan M. Orszag, Peter R. Orszag and John M. Gale) filed in conjunction with Reply Comments of EchoStar and DIRECTV ("*Economic Assessment*").

[170] *Id.*

[171] *Id.* at 7-13. This analysis is essentially the same as that described in paragraphs 36-39 above.

strategy would, in the first instance, reduce subscribership by approximately one-fifth.[172] However, cable operators would likely see increased consumer demand for their services, because of the reduced attraction of non-cable MVPDs -- some non-cable subscribers would likely switch to cable to retain access to the cable-exclusive programming. Moreover, in consideration of exclusivity, the vertically integrated programmer may be able to raise the price it charges for programming to other cable operators. This would mitigate losses of program subscription revenue attributable to the cable-only distribution strategy. Additionally, in those areas where the vertically integrated programmer is also the cable operator, the increased demand for cable service would translate into higher profits, even if retail cable rates remained unchanged. However, because of the increased demand, cable operators might be able to increase profits further by raising the price of cable service. Because four of the five largest vertically integrated cable operators serve 34 percent of all MVPD subscribers, this further suggests that these programmers could reap a substantial portion of the gains from withholding programming from rivals. A review of economic literature supports this view.[173] Thus, particularly where competitive outlets are limited in their market share, the programmer is able to recoup much, if not all, of the money that is foregone by the limited availability of its product, at the same time, imparting a valuable competitive advantage to the exclusive distributor of the programming. Moreover, if the long-term result is to limit or eliminate competition, the exclusive arrangement will result in increased profit through the subscribers that migrate from failing or defunct competitors to the programmer's cable affiliate, and through the ability to raise rates without fear of losing subscribers to competitive MVPDs.

54. The concerns outlined above are more pronounced with respect to vertically integrated regional programming distributed within an affiliated cable operator's regional cluster. In addition to noting the growing importance of regional programming services,[174] we have also observed that regional programming tends to be significantly more vertically integrated than are national programming services.[175] In such cases, a programmer foregoes only those revenues associated with DBS's penetration within the cluster, not the revenues associated with DBS subscribers nationwide. In contrast to the

[172] *Eighth Annual Report,* 17 FCC Rcd at 1338. We note that if sunset of the exclusivity prohibition occurred and vertically integrated programmers entered into exclusive arrangements with only the top ten MVPDs (excluding DBS providers), those programmers would still retain access to over 66 percent of all MVPD subscribers. *Id.* at 1341. This figure has increased three percent from the period of the *First Report on Competition* at which time a vertically integrated programmer would have been able to retain access to approximately 63 percent of all MVPD subscribers. *First Report on Competition,* 9 FCC Rcd at 7586.

[173] *See* Michael H. Riordan and Steven Salop, *Evaluating Vertical Mergers: A Post-Chicago Approach,* 63 Antitrust Law Journal 519 (1995). Under certain conditions a vertically integrated firm can harm competition and raise prices for consumers. For example, a downstream firm (affiliated cable operator) can use vertical integration with an upstream firm (vertically integrated programmer) in order to deny upstream supply to downstream rivals (nonaffiliated MVPDs). *See* Janusz Ordover, Garth Saloner, and Steven Salop, *Equilibrium Vertical Foreclosure,* American Economic Review, pp. 127-142 (Mar. 1990). By eliminating an upstream supplier to nonaffiliated MVPDs, the downstream firm can reduce competition in the upstream market, and therefore cause higher prices for nonintegrated upstream supply, thus harming those MVPDs. Additional research indicates that vertical integration coupled with exclusivity can lead to a decline in output and social welfare, as well as a drop in profits and output for the nonintegrated downstream firm. *See* Oliver Hart and Jean Tirole, *Vertical Integration and Market Foreclosure,* Brookings Papers: Microeconomics, pp. 205-286 (1990).

[174] *See supra* ¶ 19.

[175] *See supra* nn. 37, 49 & 51 and accompanying text (discussing vertical integration penetration of national and regional programming services).

national DBS penetration rate of 18 percent,[176] DBS subscriber penetration in various cities where cable MSOs have clusters is much lower. For example, DBS household penetration is 3.9 percent in Philadelphia, 5.3 percent in New York, 4.8 percent in San Francisco, and 7.3 percent in San Diego.[177] Thus, it appears that the cost to a vertically integrated cable programmer of withholding regional programming would be proportionately lower than the cost of withholding national programming. Moreover, the affiliated cable operator will reap a substantial share of the benefits of withholding programming, since its share of total cable subscribers within the cluster is, presumably, high. The harm to the competitive MVPD, and thus the incentive for the vertically integrated regional programmer to foreclose programming, is further increased in situations in which there is no readily acceptable substitute for the programming, such as regional sports programming.

55. There is also evidence based on market experience that a sunset of the exclusivity prohibition would provide incumbent cable operators with an economically sustainable mechanism for depriving developing competitive program distributors of programming content. The rationale for such withholding was observed by the Commission in its 1990 report to Congress pursuant to Section 623(h) of the Cable Communications Policy Act of 1984. There the Commission found that "vertically integrated cable operators often have the ability to deny alternative multichannel video providers access to their vertically owned programming services."[178] Congress received evidence prior to passage of the 1992 Cable Act demonstrating the ability of cable operators faced with a lack of effective competition to obtain exclusive rights to programming content.[179] After passage of the 1992 Act, the Commission has continued to observe that retention of exclusive rights to vertically integrated programming is of importance to incumbent cable operators faced with potential competition.[180] Indeed, public interest petitions for exemptions from Section 628's requirements demonstrate a belief that exclusivity may be an effective competitive tool.[181] The withholding of programming from competitors as a competitive tactic also has been evidenced by the acquisition of such rights in terrestrial-delivered content not covered by the statutory restriction.[182] This experience tends to confirm our economic analysis and confirms

[176] *Eighth Annual Report*, 17 FCC Rcd at 1341.

[177] *See* Economic Assessment at 24; *but see supra* n. 107 (challenging DBS penetration figure for Philadelphia). These city level penetration data do not correspond exactly to cable MSO cluster boundaries, and there are likely factors, such as line-of-sight, in addition to cable competition that affect city DBS penetration. Nevertheless, we believe that the city penetration data provide support for the position that DBS penetration is lower in certain cable cluster areas than nationwide.

[178] *Competition, Rate Deregulation and the Commission's Policies Relating to the Provision of Cable Television Service*, 5 FCC Rcd 4962, 5021 (1990).

[179] *See* S. Rep. No. 102-92 at 24.

[180] *See e.g., Corporate Media Partners d/b/a Americast and Ameritech New Media v. Continental Cablevision, Inc. and Home Box Office*, 12 FCC Rcd 3455 (1997); *Cellularvision of New York, LP v. SportsChannel Associates*, 11 FCC Rcd 3001 (1996); *Bell Atlantic Video Services Co. v. Rainbow Programming Holdings, Inc. and Cablevision Systems Corp.*, 12 FCC Rcd 9892 (1997); *Electric Plant Board City of Glasgow, KY v. Turner Network Cable Sales, Inc.*, 9 FCC Rcd 4855 (1994).

[181] *See e.g., Outdoor Life Network and Speedvision Network*, 13 FCC Rcd 12226 (1998); *Cablevision Industries Corp. and Sci-Fi Channel*, 10 FCC Rcd 9786 (1995); *Time Warner Cable*, 9 FCC Rcd 3221 (1994); *Time Warner Cable*, 9 FCC Rcd 4029 (1994); *New England Cable News*, 9 FCC Rcd 3231 (1994); *Newschannel*, 10 FCC Rcd 691 (1994).

[182] *See DIRECTV, Inc. v. Comcast Corporation*, 15 FCC Rcd 22802, 22807 (2000), *aff'g, EchoStar Communications Corporation v. Comcast Corporation*, 14 FCC Rcd 2089 (1999), *DIRECTV, Inc. v. Comcast Corporation*, 13 FCC (continued....)

statements in this proceeding from both cable operators and other MVPDs that competitors will seek, and can acquire, exclusivity to advantage themselves in the competitive struggle.[183]

C. Partial Sunset

56. In the *Notice*, we sought comment on whether the prohibition should be lifted in areas in which the level of MVPD competition reaches a certain level and whether it should be lifted as to all MVPD competitors or solely for MVPDs of sufficient competitive presence.[184] Cable MSOs direct our attention to the success of DBS competitors and ask that we, at minimum, allow partial sunset of Section 628(c)(2)(D), arguing that vertically integrated programmers lack the incentive to deny programming to such significant market competitors. These commenters assert that, even if the Commission believes the prohibition continues to be necessary for new entrants and small competitors, it cannot find that it is so for DIRECTV and EchoStar, the third and seventh largest MVPDs respectively.[185]

57. We agree that it is likely that it would not be in the economic interest of a vertically integrated entity to withdraw some programming channels from satellite distribution. Prior to adoption of any governmental limitations on exclusivity there clearly were vertically integrated programming services that did not engage in exclusive sales practices.[186] And, depending on factors such as the nature of the programming, the established economic model underlying its operation, and the size and geographic location and growth expectations of the vertically integrated cable system, it may not make economic sense for such an entity to withdraw an existing service or collection of services from DBS distribution. Moreover, there clearly are services that either lack sufficient subscriber appeal to make them critical to the competitive success of DBS or for which reasonable substitutes are either available or could be created.

58. The decision whether or not to sunset the prohibition, however, is not related to the loss or lack of need for particular services but to the effect abolition of the limitation would have on competition and diversity in the distribution of video programming generally. We are persuaded that the costs that competition imposes on established cable service providers are sufficiently high that the incentive to withhold some important programming services exists and likely would be exercised in a manner that would reduce competition. We need not anticipate that a partial sunset would necessarily lead to the wholesale foreclosure of vertically integrated programming to DIRECTV or EchoStar to conclude that the limitation remains necessary. Such wholesale foreclosure is not necessary to injure either provider's ability to compete. Cable operators in purchasing additional systems have been willing to pay as much as $4000-$6000 for each subscriber acquired.[187] Protection of this investment provides an extraordinary degree of motivation in terms of programming sales as well as other competitive

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Rcd 21822 (1998), *aff'd sub nom. EchoStar Communications Corporation v. FCC*, No. 01-1032 (D.C. Cir. June 11, 2002); *RCN Telecom Services of New York, Inc. v. Cablevision Systems Corp.*, 16 FCC Rcd 12048 (2001).

[183] *See e.g.*, AOLTW Comments at 13-18; AOLTW Reply Comments at 11; Cablevision Comments at 18; AT&T Comments at 10; Comcast Comments at 13; NCTA Comments at 15; BELD Comments at 1; Joint Comments at 13.

[184] *Notice*, 16 FCC Rcd at 19080.

[185] *Eighth Annual Report*, 17 FCC Rcd at 1341.

[186] For example, we understand that CNN has been available to all MVPDs since its inception.

[187] *Eighth Annual Report*, 17 FCC Rcd at 1335.

considerations. Although vertically integrated program providers must still recoup, through higher programming rates, a share of the value they provide to nonaffiliated cable systems through exclusivity if they withhold content from DBS, consolidation within the industry since passage of the 1992 Act[188] affords operators greater direct incentives to advantage their own system operations even at the cost of some immediate advantage in terms of foregone revenues from content distribution to competitors.

59. Because the prohibition has been in effect for the last decade, the availability of direct evidence of how the market would react in the absence of the restriction is limited. However, the marketplace evidence that does exist tends to confirm that, where permitted, vertically integrated programmers will use foreclosure of programming to provide a competitive edge to their affiliated cable operators.[189] The evidence suggests that the ability to foreclose vertically integrated programming is especially significant in the regional programming market which may not be covered by the rules if the programming is distributed terrestrially. This type of programming has in fact been withdrawn from DBS competitors.[190] Further, the national distribution of DBS services, and the large DBS subscriber base do not provide the economic base for substantial regional programming investments of the type that cable MSOs have developed for their system clusters. Without a sufficient mass of subscribers on a regional basis, DBS lacks the market presence that would make it economically rational to produce regional programming to compete with vertically integrated regional programming on a market-by-market basis. Access to regional programming is an important component of competitive success, and the withdrawal of regional services by itself would threaten the preservation of competition and diversity in the distribution of video programming.[191]

60. We have already discussed the continuing importance of vertically integrated programming to the viability of competitive MVPDs – the foreclosure of even a small part of which would damage an MVPD's ability to compete.[192] We believe that vertically integrated programmers, given the opportunity, will foreclose strategic programming, either new or existing, to one or both DBS competitors to undermine their service offering and harm their competitive ability. Such targeted foreclosure could be accomplished even while selling the majority of their program offerings to one or both providers. Permitting such conditions to arise through a partial sunset would be inconsistent with our instruction to retain the prohibition if it "continues to be necessary to preserve and protect competition and diversity in the distribution of video programming."[193] We need not reach the question of whether partial sunset is permissible under the statute because we find that it is necessary to apply the exclusivity prohibition to the market as a whole in order to reach the statutory objectives under current market conditions.

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[188] *See supra* ¶¶ 21-22 & 47 (discussing clustering and consolidation with the cable industry).

[189] *See supra* n. 182 and accompanying text (discussing vertically integrated programmers foreclosure of terrestrially distributed programming to MVPDs both large and small).

[190] *See DIRECTV, Inc. v. Comcast Corporation*, 15 FCC Rcd at 22807.

[191] *See supra* ¶ 47 (discussing the importance of vertically integrated regional programming).

[192] *See supra* ¶¶ 32-33 (discussing importance of vertically integrated programming to competitive MVPDs).

[193] 47 U.S.C. § 548(c)(5). We note that, even were we to partially sunset the prohibition as to one or more DBS operators, the prohibition on exclusive arrangements would continue to apply to vertically integrated cable operators in areas the were unserved by cable as of the enactment of the 1992 Cable Act (October 5, 1992). *See infra* ¶¶ 75-76 (discussing Section 628(c)(2)(C) of the Communications Act).

D. Diversity

61. We briefly discuss the issue of diversity within the context of Section 628(c)(5). Cable MSOs contend that exclusivity is necessary to spur MSO investment in programming and to ensure the creation and development of new cable networks.[194] Cable MSOs contend that DBS, in particular, has the financial wherewithal to develop programming, but has not done so.[195] Competitive MVPDs, on the other hand, assert that extending the exclusivity ban will not significantly reduce incentives to create new or more diverse programming.[196] These commenters argue that in the past ten years since the ban has been in effect, the quantity and diversity of video programming has greatly increased.[197] Competitive MVPDs also argue that the cost of vertical integration upstream for some competitors is a significant impediment to competitive entry.[198] ACA argues that their members are not media companies and no realistic expectation can exist that small cable companies could launch their own news, entertainment, and educational programming to replace CNN, TNT, Discovery, Animal Planet, or other core satellite programming services.[199]

62. Commenters have almost exclusively devoted comment on the issue of diversity to the prohibition's impact on programming diversity. We recognize that this is certainly a component of our analysis. We note, however, that Section 628(c)(5) instructs the Commission to determine whether Section 628(c)(2)(D) remains necessary to "preserve and protect . . . diversity in the *distribution* of video programming. "[200] In this regard, one of Congress' express findings in enacting the 1992 Cable Act was that "[t]here is a substantial governmental and First Amendment interest in promoting a diversity of views provided through multiple technology media."[201] These provisions persuade us that, in considering whether to retain the exclusivity prohibition, our primary focus should be on preserving and protecting diversity in the distribution of video programming -- *i.e.*, ensuring that as many MVPDs as possible remain viable distributors of video programming.

63. Under this analysis, we believe that retaining the prohibition is necessary to preserve and protect diversity in the distribution of programming. Other than the two largest non-cable MVPDs, DIRECTV and EchoStar,[202] nonaffiliated cable operators and competitive MVPDs, such as BELD, Carolina Broadband, CNI Wireless, Everest, Altrio, Qwest, RCN, Wide Open West and WSNet to name a few, assert that they lack the resources and ability to develop their own programming and are thus

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[194] AT&T Comments at 11; Cablevision Comments at 13.

[195] Cablevision Comments at 16; Comcast Comments at 14. These commenters argue that the one new program offering which has been developed by a DBS operator -- NFL Sunday Ticket -- is only available on a DBS-exclusive basis. Cablevision Comments at 16; AT&T Comments at 9.

[196] EchoStar Reply Comments at 21; CBC Reply Comments at 5.

[197] EchoStar Reply Comments at 21; CBC Reply Comments at 5.

[198] BSPA Reply Comments at 10; ACA Reply Comments at 5.

[199] ACA Reply Comments at 5.

[200] 47 U.S.C. § 548(c)(5) (emphasis added).

[201] 1992 Cable Act § 2(a)(6).

[202] In terms of developing new programming, DBS providers point to EchoStar's agreement with Vivendi Universal as an indication of how a DBS provider is facilitating the entry of new programming on a non-exclusive basis. *See* EchoStar Reply Comments at 22; *Economic Assessment* at 26.

dependent on access to the programming of others, including "must have" vertically integrated programming. We have already concluded that access to vertically integrated programming continues to be important to the success of nonaffiliated cable operators and competitive MVPDs, and that vertically integrated programmers continue to have the incentive and ability to favor their affiliated cable operators such that competition and diversity in the distribution of video programming would not be preserved and protected. We have also noted that, other than DBS providers, subscribership to competitive MVPDs has remained flat, or actually declined, over the last several years. Were the prohibition on exclusivity permitted to sunset, access to vertically integrated programming would be limited or foreclosed and the viability of these MVPDs would be threatened. Even with respect to DBS, we conclude that some foreclosure is likely and that such foreclosure would impose a competitive risk to such providers. Extending the prohibition on exclusivity therefore remains necessary to preserve and protect diversity in distribution of video programming.

64. Finally, we believe that the retention of the exclusivity prohibition will not reduce the incentives to create new or diverse programming. As demonstrated from the record before us, the number of national programming services increased since the enactment of the prohibition on exclusivity from 87 in 1992 to 294 in 2001.[203] Moreover, the number of vertically integrated services has nearly doubled since 1994.[204] We do not believe that the exclusivity prohibition has been a disincentive for cable MSOs to develop new profitable cable networks.[205]

E. Conclusion

65. The competitive landscape of the market for the distribution of multichannel video programming has changed for the better since 1992. The number of MVPDs that compete with cable and the number of subscribers served by those MVPDs have increased significantly. We find, however, that the concern on which Congress based the program access provisions -- that in the absence of regulation, vertically integrated programmers have the ability and incentive to favor affiliated cable operators over nonaffiliated cable operators and programming distributors using other technologies such that competition and diversity in the distribution of video programming would not be preserved and protected – persists in the current marketplace. Controlling 78 percent of all MVPD subscribers, cable operators continue to decisively dominate the market for the distribution of programming. DBS has been relatively successful in attracting subscribers over the last few years, garnering nearly one-fifth of MVPD subscribers. We will continue to monitor DBS's progress in the market and plan to examine in future proceedings, whether the prohibition remains necessary to that class of competitor, or a subset thereof. Competitors other than DBS, however, such as cable overbuilders, open video systems, and MMDS, have not been as successful. Vertically integrated programming, although not as pervasive as it was in 1992, continues to play a significant part in the channel package of any viable MVPD. Moreover, vertically integrated programmers continue to have the incentive and ability to favor affiliated cable operators over other MVPDs such that competition and diversity in the distribution of video programming would not be preserved and protected. Given these findings, we conclude that, were the prohibition on exclusive

[203] NCTA Comments at 12; *Eighth Annual Report*, 17 FCC Rcd at 1249.

[204] *See First Report on Competition*, 9 FCC Rcd at 7589-90 (56 vertically integrated programming services); *Eighth Annual Report*, 17 FCC Rcd at 1309 (104 vertically integrated programming services).

[205] In fact, DBS competitors credit the exclusivity prohibition in making DBS a competitive option to cable thereby spurring program diversity. DBS competitors claim that their ability to offer more channels digitally has pressured cable firms to invest in increased channel capacity, thus providing new opportunities to programmers. EchoStar Reply Comments at 22; *Economic Assessment* at 26.

contracts permitted to sunset in the current market conditions, competition and diversity in the distribution of video programming would not be preserved and protected.[206]

VI. SCOPE OF EXCLUSIVITY PROHIBITION

A. Narrowing the Prohibition.

66. In the *Notice,* we discussed whether the Commission should consider narrowing the scope of, rather than eliminating, the exclusivity restriction.[207] In pointing out that certain programming services may be more essential than others to the viability and success of competing program distributors, we sought comment on whether the exclusivity prohibition could be limited to cover only essential programming services.[208] We requested comment on the extent to which limiting the prohibition to particular services raises First Amendment concerns.[209] The *Notice* also sought comment on whether the prohibition on exclusivity should be tied to the specific geographic circumstances of an area.[210] We also questioned whether the exclusivity prohibition should apply to areas in which a programming service is not vertically integrated with the local cable operator.[211] The consensus from the few parties commenting

[206] We do not believe other provisions in the statute – namely, Sections 628(b), 628(c)(2)(A), and 628(c)(2)(B) – are adequate substitutes for the particularized protection afforded under Section 628(c)(2)(D). Section 628(c)(2)(D) provides a limited, targeted and temporary means for ensuring that effective competition develops in the MVPD marketplace. This provision temporarily favors competitive development over exclusive rights for the period necessary to preserve and protect competition. While Section 628(c)(2)(D) remains in effect, exclusive contracts generally are prohibited unless the Commission finds that exclusivity is in the public interest. The burden is placed on the party seeking exclusivity to show that a specific exclusive contract meets the statutory public interest standard before any such contract can be enforced. *First Report and Order*, 8 FCC Rcd at 3384, 3386. No other program access provision provides this protection.

We initially note that these provisions were all enacted as part of the 1992 Cable Act. Thus, despite the existence of these other program access provisions, Congress found the exclusivity prohibition of Section 628(c)(2)(D) to be necessary to preserve and protect competition and diversity. Moreover, as compared to Section 628(c)(2)(D), Section 628(b) addresses "unfair or deceptive acts or practices" generally and carries with it an added burden "to demonstrate that the purpose or effect of the conduct complained of was to 'hinder significantly or to prevent' an MVPD from providing programming to subscribers or customers." *Id.* at 3377-78; *Memorandum Opinion and Order on Reconsideration of the First Report and Order*, 10 FCC Rcd 1902, 1930 (1994). We have recognized that Section 628(c)(2)(A)'s safeguard against undue influence will "play a supporting role" to Sections 628(c)(2)(B), (C) and (D), "where information is available (such as might come from an internal 'whistleblower') that evidences 'undue influence' between affiliated firms to initiate or maintain anticompetitive discriminatory pricing, contracting, or product withholding." *Id.* at 3424 (conduct of undue influence necessary to establish a violation of section 628(c)(2)(A) "may be difficult for the Commission or complainants to establish"). Finally, while we recognize that Section 628(c)(2)(B) prohibits "non-price discrimination," a 628(c)(2)(B) complainant must demonstrate the conduct was "unreasonable" which again may be difficult to establish given the widespread use of exclusive contracts in the commercial marketplace. Given these limitations, we believe the exclusivity prohibition in Section 628(c)(2)(D) "continues to be necessary to preserve and protect competition and diversity in the distribution of video programming."

[207] *Notice*, 16 FCC Rcd at 19080.

[208] *Id.*

[209] *Id.*

[210] *Id.*

[211] *Id.*

on this issue is that the scope of the exclusivity prohibition should not be narrowed to apply to certain core or essential programming services or specified geographic areas.[212]

67. DIRECTV asserts that the Commission should not set itself up as the arbiter of which programming is essential, but credits the Commission for recognizing the First Amendment issues arising from such a content-based determination.[213] EchoStar states that a ratings-based test would not reflect the importance to consumers of having a complete complement of channels.[214] Cablevision argues that attempts to define essential programming would entangle the Commission into subjective and unproductive inquiries about the value of certain programming.[215] An additional approach suggested by RCN proposes that programming that is able to be duplicated or replicated by a competitor through the expenditure of its own resources should be excluded from the scope of the prohibition. RCN argues that programming that cannot be replicated, such as local sports programming, should be covered by the prohibition.[216] For example, RCN proposes that a locally-produced news or public affairs program, the content of which could reasonably be duplicated by any MVPD competitor, need not be subject to the exclusivity prohibition, whereas sports programming (because of the uniqueness of particular sports programming and the inability to be readily duplicated) would be covered by the prohibition.[217] Cablevision counters that RCN's proposal to define "duplicable" programming would be problematic.[218]

68. In Demand, a provider of pay-per-view ("PPV") services,[219] argues that the justification for allowing the exclusivity prohibition to sunset is particularly compelling with respect to PPV programming.[220] It asserts that DBS operators have developed a sophisticated PPV business that exceeds the PPV offering of cable operators and that there are substantial existing and emerging competitors in the PPV arena, including MMDS providers, SMATV operators, and cable overbuilders, providing a variety of PPV options to their customers.[221] Consequently, In Demand asserts that there is no basis to find that the exclusivity prohibition continues to be necessary to preserve and protect competition and diversity in the distribution of PPV programming.[222] Moreover, In Demand argues that since Congress authorizes the Commission, pursuant to Section 628(c)(5), to allow the exclusivity prohibition to sunset for *all* vertically

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[212] DIRECTV Comments at 9; Everest Comments at 7; EchoStar Comments at 19-20.

[213] DIRECTV Comments at 9; Everest Comments at 7.

[214] EchoStar Comments at 19-20.

[215] Cablevision Reply Comments at 21.

[216] RCN Comments at 38.

[217] *Id.*

[218] Cablevision Reply Comments at 20-21.

[219] Pay-per-view programming is video programming such as movies and events (sporting events and concerts) that an MVPD makes available to its customers for a per-movie or per-event fee, or in the case of sports packages, a flat package price, at predetermined start times. The customer can order particular movies or events either using a remote control and set-top box or by calling a telephone number to have the cable operator authorize the customer's set-top box. In Demand Comments at 1-2.

[220] In Demand Comments at 3.

[221] *Id.* at 4,12. According to In Demand, DIRECTV devotes approximately 60 channels to PPV and sport packages and EchoStar has over 20 channels of PPV. *Id.* at 9.

[222] *Id.* at 4.

integrated satellite cable programming services, the Commission may do something *less* than authorized, by narrowing the scope of the exclusivity to certain video programming services, exempting services such as PPV.[223] In addition, In Demand asserts that the extent to which PPV services are covered by the program access rules is unclear because the PPV business was in its "embryonic" stage in 1992 and the prohibition provisions may not have been intended to extend to PPV.[224]

69. We concur with the majority of commenters that the scope of the exclusivity prohibition should not be altered to apply to particular types of programming that are considered essential programming services. Although the Commission has recognized that certain programming services, such as sports programming, or marquee programming, such as HBO, may be essential and for all practical purposes, "must haves" for program distributors and their subscribers,[225] we recognize the difficulty of developing an objective process of general applicability to determine what programming may or may not be essential to preserve and protect competition. Besides being difficult to classify which programming services would be designated essential, making such a channel-by-channel determination would place the Commission in the untenable position of designating certain programming as more essential than others and thus raise constitutional questions. We believe treating all satellite cable programming and satellite broadcast programming uniformly for purposes of the exclusivity prohibition is consistent with Section 628(c)(2)(D) and the definitions set forth in Sections 628(i)(1) and (3).[226] We will therefore not narrow the scope of the exclusivity prohibition to only so-called essential programming services. With regard to PPV, the basis of our decision regarding PPV is consistent with our determination regarding other satellite programming services affiliated with a cable operator. Because we are not changing the scope of the program access provisions, if a PPV service provider is vertically integrated with a cable operator and provides satellite cable programming as defined by the Communications Act,[227] it is subject to the program access rules, including the prohibition regarding exclusive contracting.

70. There was a dearth of comment on the geographic limitation issue. Everest states that the limitation on exclusivity should not be tied to the specific geographic or competitive circumstances of an area.[228] DIRECTV asserts that Section 628(c)(2)(D) already contains the relevant geographic limitation mandated by Congress by prohibiting exclusive agreements between cable operators and vertically integrated programmers "in areas served by a cable operator."[229] Based on the meager record on this issue, we agree with DIRECTV that Congress apparently delineated a geographic demarcation applicable

[223] *Id.* at 15.

[224] *Id.* at 8.

[225] *See Competition, Rate Deregulation and the Commission's Policies Relating to the Provision of Cable Television Service,* 5 FCC Rcd 4962, 5027 (1990).

[226] The term "satellite cable programming" means video programming which is transmitted via satellite and which is primarily intended for the direct receipt by cable operators for their retransmission to cable subscribers. 47 U.S.C. §605(d)(1); *see also* 47 U.S.C. § 548(i)(1). The term satellite broadcast programming means broadcast video programming when such programming is retransmitted by satellite and the entity retransmitting such programming is not the broadcaster or an entity performing such retransmission on behalf of and with the specific consent of the broadcaster. 47 U.S.C. § 548(i)(3).

[227] *Id.*

[228] Everest Comments at 7.

[229] DIRECTV Comments at 9.

to the prohibition -- areas served by a cable operator. Given this language, we decline in this proceeding to alter the applicability of the prohibition to a geographic area other than that set forth in Section 628(c)(2)(D).

B. Expanding the Prohibition

71. Section 628(c)(2)(D) is applicable to cable operators, satellite cable programming vendors in which a cable operator has an attributable interest, and satellite broadcast programming vendors in which a cable operator has an attributable interest.[230] Numerous commenters submit that the scope of the provision should be extended to include terrestrially delivered programming as well as non-vertically integrated programming. Some competitive MVPDs contend that cable affiliated regional sports programming and other regional services such as local news networks are being moved to terrestrial modes of distribution to circumvent the exclusivity prohibition and that the Commission should close what they refer to as the "terrestrial loophole" by applying Section 628(c)(2)(D)'s prohibition to cable-affiliated programming services regardless of the mode of delivery. Cable MSOs assert that terrestrially delivered programming is outside the scope of the exclusivity ban in Section 628(c)(2)(D).[231]

72. RICA argues that large, well-entrenched cable incumbents that have exclusive contracts with unaffiliated programming vendors are able to prevent new entrants from competing in a meaningful way. RICA asserts that lack of programming not only deters new customers from signing up with a competitor, but also drives customers back to the incumbent.[232] Viacom urges the Commission to reject requests for extending the program access exclusivity ban to non-vertically integrated satellite-delivered programming suppliers or otherwise increasing regulation of program distribution.[233] Viacom contends that regulatory action would impede the continuing diversity and growth of independent programming in the marketplace.[234] Viacom asserts that it has used exclusivity in order to build a distribution base for its programming because it lacks the ready pool of commonly-owned cable subscribers of a vertically integrated program service.[235] DIRECTV also asserts that exclusivity between non-cable MVPDs and non-vertically integrated programmers has been a boon to new MVPD entrants.[236] NCTA notes that the Commission has repeatedly and properly refused to interfere with affiliation decisions of independent,

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[230] 47 U.S.C. § 548(a).

[231] NCTA Reply Comments at 16; AOLTW Reply Comments at 13-14; Cablevision Reply Comments at 17.

[232] RICA Comments at 5.

[233] Viacom Reply Comments at 3.

[234] *Id.* at 7.

[235] *Id.* at 5. Viacom points to its TV Land Programming as an example of how exclusivity has helped to assist an independent, unproven programming service. Viacom notes that it entered into short-term exclusive distribution arrangements after the launch of TV Land in an effort to attain the level of distribution necessary for the service to become economically viable and once that was accomplished the programming then became widely available to multiple MVPDs on a non exclusive basis. *Id.*

[236] DIRECTV Comments at 7. DIRECTV notes that the National Football League is a non-vertically integrated program provider with whom DIRECTV has an agreement to be the exclusive DBS distributor of NFL Sunday Ticket and that this exclusive offering has been an important way for DIRECTV to distinguish itself in the MVPD market. *Id.*

non-vertically integrated programmers, finding no evidence to warrant government intervention in these private negotiations.[237]

73. The Commission has noted that terrestrial distribution of programming could have a substantial impact on the ability of competitive MVPDs to compete in the MVPD market.[238] Nonetheless, the Commission has concluded that the language of Section 628(c) expressly applies to "satellite cable programming and satellite broadcast programming," and that terrestrially delivered programming is "outside of the direct coverage of Section 628(c)."[239] We have been presented with no basis to alter that conclusion in this proceeding. To the contrary, the legislative history to Section 628 reinforces our conclusion. The Senate version of the legislation that became Section 628 would have applied the program access provisions to all "national and regional cable programmers who are affiliated with cable operators."[240] The House version, by contrast, expressly limited the provisions to "satellite cable programming vendor[s] affiliated with a cable operator."[241] The Conference agreement adopted the House version with amendments.[242] Given this express decision by Congress to limit the scope of the program access provisions to satellite delivered programming, we continue to believe that the statute is specific in that it applies only to satellite delivered cable and broadcast programming.

74. With regard to non-vertically integrated programming, we note that Congress designed the program access rules to constrain the ability of cable operators and vertically integrated programmers to impede the development of nonaffiliated cable operators and competitive MVPDs. The program access rules, including the exclusivity prohibition, apply only to satellite-delivered program services in which a cable operator has an attributable interest. The program access provisions do not prohibit exclusive arrangements between cable operators and independent programmers. The record in this proceeding provides no support for statutory authority to expand the program access rules to include independent programmers within the exclusivity prohibition.[243] Such an expansion would directly contradict Congress' intent in limiting the program access provisions to a specific group of market participants.

C. Exclusive Contracts in Areas Not Served by Cable

75. Section 628(c)(2)(C) of the Communications Act prohibits all "practices, understandings, arrangements and activities, including exclusive contracts" that prevent an MVPD from obtaining

[237] NCTA Reply Comments at 18-19, citing *Dakota Telecom, Inc. v. CBS Broadcasting, Inc.*, 14 FCC Rcd 10500, 10506 (1999).

[238] *See 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,* 13 FCC Rcd 15822, 15856 (1998).

[239] *See DIRECTV, Inc. v. Comcast Corp. et al.*, 15 FCC Rcd 22802 (2000).

[240] *See* H.R. Conf. Rep. 102-862, 102nd Cong., 2nd Sess. 91 (1992).

[241] *Id.* at 92.

[242] *Id.* at 93. The Conference agreement amended the House version to apply also to "satellite broadcast programming vendors." *Id.*

[243] The Commission has previously rejected attempts to expand the program access rules to include non-vertically integrated programmers. *See Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming,* 15 FCC Rcd 978, 1066 (2000).

vertically integrated programming "for distribution to persons in areas *not* served by a cable operator as of the date of enactment" of the 1992 Cable Act, October 5, 1992.[244] Section 628(c)(2)(C) is not subject to potential sunset. By contrast, the prohibition on exclusive arrangements of Section 628(c)(2)(D) applies to "areas served by a cable operator" and is subject to the sunset provision of Section 628(c)(5). We sought comment on whether the sunset of Section 628(c)(2)(D) would impact the prohibition set forth in Section 628(c)(2)(C) and whether the prohibition in Section 628(c)(2)(C) would continue to bar exclusive agreements in areas that were not served by a cable operator before October 5, 1992, but in which cable service has commenced in the intervening years.[245] DIRECTV argues that a sunset of Section 628(c)(2)(D) would have no impact on Section 628(c)(2)(C)'s absolute ban on exclusive agreements.[246] With regard to the provision in Section 628(c)(2)(C) regarding "areas not served by a cable operator *as of the date of enactment of this section,*" DIRECTV indicates that this provision was given a fixed definition by Congress, defined by reference to unserved areas as they existed when the 1992 Cable Act was enacted.[247] The NRTC states that the Commission would still be required to enforce the exclusivity prohibition required under Section 628(c)(2)(C) in areas not served by cable in the event the Commission allows Section 628(c)(2)(D) to sunset.[248]

76. As we observed in the *Notice,* Section 628(c)(5) permits the sunset only of the exclusivity prohibition of Section 628(c)(2)(D) while preserving the overall structure of program access and Section 628.[249] The presence or absence of Section 628(c)(2)(D) has no impact on the continuing implementation of Section 628(c)(2)(C), as each provision is separate and independent of the other. Section 628(c)(2)(C) serves the purpose of prohibiting exclusive agreements "in areas not served by a cable operator *as of the date of enactment of this section.*"[250] In the *First Report and Order,* we concluded that Section 628(c)(2)(C) was unequivocal.[251] Our interpretation remains unchanged -- the specific language Congress adopted and what it intended is clear. The phrase "areas not served by a cable operator as of the date of enactment" indicates that the exclusivity prohibition applies to areas unserved by cable as of October 5, 1992, regardless of whether such area has been subsequently served by cable. We will continue to enforce Section 628(c)(2)(C) as enacted by Congress.

VII. NEW TERM FOR EXCLUSIVITY PROHIBITION

77. Although Congress established a date for the exclusivity prohibition to sunset if we determined that its existence no longer was necessary, no specific time period was established in the event that it did not sunset. Because the statute does not expressly state a term of years for the prohibition to continue, the Commission will by rule prescribe the period. Given this discretion, we requested comment regarding the length of time the provision should be retained, whether the provision should automatically sunset at the end of a further period, or whether the Commission should at that time be required to revisit

[244] 47 U.S.C. § 548(c)(2)(C) (emphasis added); *see also* 47 C.F.R. § 76.1002(c)(1).

[245] *Notice,* 16 FCC Rcd at 19079-80.

[246] DIRECTV Comments at 4.

[247] *Id.* at 5 (emphasis original).

[248] NRTC Comments at 7.

[249] *Notice,* 16 FCC Rcd at 19079.

[250] 47 U.S.C. § 548(c)(2)(C) (emphasis added).

[251] *First Report and Order,* 8 FCC Rcd at 3383.

and analyze the continuing value and need for Section 628(c)(2)(D).[252] Although many commenters have urged the Commission to extend the current prohibition beyond the October 5, 2002 sunset date, few set forth a time frame for continuation of the requirement. RCN indicates that it is not aware of any marketplace factors that would suggest that an extension of the ban should be either longer or shorter than the period chosen by Congress.[253] RCN additionally argues that development of the MVPD market since 1992 illustrates the time frame in which reasonable competitive progress can be anticipated, and it is not substantially less than 10 years.[254] Another approach suggested by Everest is that the Commission extend the sunset period for Section 628(c)(2)(D) at least until January 1, 2006, to coincide with the expiration of the existing prohibition on exclusive retransmission consent agreements between television broadcast stations and MVPDs.[255] According to Everest, the Commission will be in a better position at that time to assess whether there is meaningful competition.[256] Joint Reply Commenters argue that it would be premature for the Commission to conclude that terrestrial competitors no longer will require protection against exclusive cable programming contracts by January 1, 2006, or any other date certain.[257]

78. In enacting the exclusivity prohibition, Congress sought to establish a video programming marketplace that is competitive and diverse, and made provisions in the statute for the protection against potentially anticompetitive exclusive agreements to continue until these objectives are achieved. Establishing a predetermined date on which the prohibition would automatically sunset without conducting a further proceeding to determine whether these objectives are met is not consistent with this congressional intent. What we seek in continuing to enforce the exclusivity prohibition is a video programming environment consonant with that envisioned by Congress in 1992. The language of Section 628(c)(5) indicates that Congress intended the prohibition to sunset, but only when it no longer was necessary to preserve and protect competition and diversity in the distribution of video programming.

79. Congress initially set a 10 year period for Commission review of Section 628(c)(2)(D). At the time the exclusivity prohibition was enacted, the MVPD market operated without effective competition and very limited non-vertically integrated programming choices. The success of some competitive MVPDs and the increase in national programming networks over the past 10 years demonstrates that program access, and the exclusivity provision in particular, are serving their purpose. Some of the trends that we have observed are moving the MVPD distribution and program production sectors toward the type of market structure in which the exclusivity prohibition could in time be lifted. These trends include the steady increase in non-cable MVPD market share and the expansion of independently-produced program channels (including such popular areas as news, children's programming, and movies), and the decline in vertically integrated programmers. Given these trends, we believe that extending the exclusivity prohibition for an additional 10 years is not required. We believe an additional 5 year term provides a sufficient time period in which the video distribution marketplace may have the opportunity to achieve the level of competition and diversity envisioned by Congress. Given the pace of competitive development over the last 10 years, we believe, based on our expertise in this area, that a period shorter than 5 years likely would be insufficient for the market to develop to the

[252] *Notice,* 16 FCC Rcd at 19080.

[253] RCN Comments at 28.

[254] *Id.*

[255] Everest Comments at 8.

[256] *Id.*

[257] Joint Reply Comments at 20.

point at which the sunset of the prohibition would be appropriate. Moreover, we also decline to tie the sunset of the exclusivity prohibition provision to the January 1, 2006, termination date for the prohibition on exclusive retransmission consent agreements. Although both provisions involve prohibition of exclusive contracts, they are not so intertwined that consolidating the termination dates is appropriate. Should a dramatic shift in the competitive landscape occur before 5 years, the Commission could initiate its review earlier either on its own motion or in response to a petition. Moreover, as discussed above, the Commission will continue to evaluate petitions for exclusivity under the public interest factors established by Congress.[258]

80. Based on the record in this proceeding, we conclude that the term of the prohibition on exclusive agreements between cable operators and vertically integrated programmers should extend for 5 years from October 5, 2002. Thus, the prohibition on exclusivity will expire on October 5, 2007, unless circumstances in the video programming marketplace indicate that the prohibition continues to be necessary within the meaning of the statute. Accordingly, during the year before the expiration of the 5-year term, the Commission will undertake a review to again determine whether the exclusivity prohibition continues to be necessary to preserve and protect competition and diversity in the distribution of video programming.

VIII. PROCEDURAL MATTERS

81. *Final Regulatory Flexibility Analysis.* As required by the Regulatory Flexibility Act ("RFA"), *see* 5 U.S.C. § 603, an Initial Regulatory Flexibility Analysis ("IRFA") was incorporated into the *Notice*. The Commission sought written public comment on the possible significant economic impact of the proposed policies and rules on small entities in the *Notice*, including comments on the IRFA. Pursuant to the RFA, *see* 5 U.S.C. § 604, a Final Regulatory Flexibility Analysis is contained in Appendix C.

82. *Paperwork Reduction Act of 1995 Analysis.* Although the *Notice* indicated that some of the issues on which we sought comment might entail a modified information collection subject to the Paperwork Reduction Act of 1995 ("PRA"), Public Law 104-13, the rule change adopted herein does not affect the information collection previously approved by the Office of Management and Budget ("OMB") under Control Number: 3060-0551.

[258] *See supra* nn. 84-85 and accompanying text (discussing petitions for exclusivity under the public interest factors of Section 628(c)(4)).

IX. ORDERING CLAUSES

83. Accordingly, **IT IS ORDERED** that, pursuant to authority found in Sections 4(i), 303(r) and 628 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154(i), 303(r) and 548, the Commission's rules **ARE HEREBY AMENDED** as set forth in Appendix B.

84. **IT IS FURTHER ORDERED** that the rule adopted herein **WILL BECOME EFFECTIVE** 15 days after publication in the Federal Register.

85. **IT IS FURTHER ORDERED** that the Commission's Consumer and Government Affairs Bureau **SHALL SEND** a copy of this *Report and Order*, including the Final Regulatory Flexibility Analysis, to the Chief Counsel of the Small Business Administration.

FEDERAL COMMUNICATIONS COMMISSION

Marlene H. Dortch
Secretary