A Partnership Including
Professional Corporations
600 13th[th] Street, N.W.
Washington, D.C. 20005-3096
202-756-8000
Facsimile 202-756-8087
http://www.mwe.com

Boston
Chicago
London
Los Angeles
Miami
Moscow
Orange County
New York
St. Petersburg
Silicon Valley
Vilnius
Washington, D.C.

Robert S. Schwartz
rschwartz@mwe.com
202-756-8081

McDERMOTT, WILL & EMERY

September 26, 2002

VIA ECFS

Ms. Marlene H. Dortch
Federal Communications Commission
Office of the Secretary
445 12th Street, SW
Washington, D.C. 20554

Re: *Ex Parte* Presentation; In the Matter of Implementation of Section 304 of the Telecommunications Act of 1996; Commercial Availability of Navigation Devices; CS Docket No: 97-80

Dear Ms. Dortch:

In accordance with Section 1.1206 of the Federal Communications Commission rules, the attached press release and congressional testimony of the Consumer Electronics Retailers Coalition ("CERC"), dated September 25, 2002, are provided for filing in this Docket.

Very truly yours,

Robert S. Schwartz

cc: Rick Chessen
Bill Johnson
Deborah Klein
Tom Horan
Michael Lance
Susan Mort
Michael Perko
Bob Pepper
Amy Nathan
Chairman Powell
Commissioner Abernathy
Commissioner Copps
Commissioner Martin
Marsha MacBride
Susan Eid
Stacy Robinson
Susanna Zwerling
Catherine Bohigian

Consumer Electronics Retailers Coalition

CERC

www.ceretailers.org

For Immediate Release

Contact: Bob Schwartz
202 756-8081
RSchwartz@MWE.com

CONSUMER ELECTRONICS RETAILERS PRAISE COMMITTEE INSISTENCE ON FULL CABLE COMPETITION

McCollough Tells House Commerce Subcommittee Transition To Digital Television Will Fail If It Ignores Consumer Needs

Washington, September 25, 2002 -- The Consumer Electronics Retailers Coalition (CERC) told a subcommittee of the House Energy and Commerce Committee today that it supports the efforts of the Committee's leadership, under Chairman Billy Tauzin (R-LA) and ranking Member John Dingell (D-MI), to accelerate the transition to digital television by clearing the way for new competitive products that work directly on digital cable systems.

Speaking for CERC, Circuit City CEO Alan McCollough told the Subcommittee on Telecommunications And The Internet, chaired by Rep. Fred Upton (R-MI):

> "The transition can only succeed if we honestly give the consumers what they want, and not try to force them to take what others want them to have. … CERC applauds and endorses the emphasis in the staff legislative draft on achieving "plug and play" nationally portable cable compatibility, and accomplishing this as soon as possible. … Only through legitimate and broad competition can we give consumers the necessary incentive to move the digital transition forward."

-- MORE --

McCollough pointed out that approximately seventy percent of all retail customers are cable subscribers, yet retailers still cannot provide these customers with the sort of digital products that they want and need. The reason these customers are disappointed is that technical standards and license agreements, offered by the cable industry to new entrants, still will not adequately support competitive products -- such as HDTV receivers -- that would connect directly to digital cable systems.

Calling home cable devices the "last bastion of monopoly" since telephones were deregulated, McCollough said that competition will prevail only when, as in the case of telephones, everyone relies on the same open standards and interfaces. On behalf of CERC, McCollough praised the provisions in the Committee's staff legislative draft that address this "cable compatibility" issue. These provisions seek to ensure that both consumer electronics and computer devices will work seamlessly when directly connected to any digital cable system in the country. To make this happen, he urged the Committee and the Federal Communications Commission to assure that cable operators rely exclusively on the technologies and license provisions that they offer to their potential competitors in the consumer device market.

CERC also announced today the establishment of a web site, containing the full text of today's testimony, plus all FCC, CERC, CEA, and NCTA filings referred to in the CERC testimony. Until some time later today, this site may be accessed at**:** **www.ceretailers.org.cnchost.com**. Thereafter, it will be available at **www.ceretailers.org**.

CERC members include: Best Buy Co., Inc., Circuit City Stores, Inc., Good Guys, Inc., RadioShack Corporation, Sears, Roebuck And Co., Tweeter Home Entertainment Group, Inc., Ultimate Electronics, Inc., The International Mass Retail Association, The National Retail Federation, and The North American Retail Dealers Association.

# # #

Consumer Electronics Retailers Coalition

Before The
House Committee On Energy & Commerce
Subcommittee On Telecommunications
And The Internet
Hearing On H.R. ___,
Regarding The Transition To Digital Television

Statement of Alan McCollough
Chairman, President & CEO
Circuit City Stores, Inc.
For The
Consumer Electronics Retailers Coalition
September 25, 2002

Best Buy Co., Inc.
Circuit City Stores, Inc.
Good Guys, Inc.
RadioShack Corporation
Sears, Roebuck And Co.
Tweeter Home Entertainment Group, Inc.
Ultimate Electronics, Inc.
International Mass Retail Association
National Retail Federation
North American Retail Dealers Association

Before The
House Committee On Energy & Commerce
Subcommittee On Telecommunications
And The Internet
Hearing On H.R. ___,
Regarding The Transition To Digital Television

Statement of Alan McCollough
Chairman, President & CEO
Circuit City Stores, Inc.
For The
Consumer Electronics Retailers Coalition
September 25, 2002

Chairman Upton and Members of the Subcommittee:

On behalf of my colleagues in the Consumer Electronics Retailers Coalition ("CERC"), I very much appreciate your invitation to appear today. Although as retailers, we have no vested interest in any particular technology, we clearly have an interest in promoting, displaying, and demonstrating products and services that take advantage of the latest developments in technology. We operate in a highly competitive industry. We understand that our success is tied directly to our ability to give our customers what they want, and that demonstrating the benefits that advances in technology convey to our customers is a critical component of our offer. I believe the transition to digital television shares the same challenge. *The transition can only succeed if we honestly give the consumers what they want, and not try to force them to take what is in the interest of any particular group.*

CERC includes general and specialty retailers and retail trade associations. Our members include Best Buy, Circuit City, Good Guys, RadioShack, Sears,

Tweeter, and Ultimate Electronics, plus the International Mass Retail Association, the North American Retail Dealers Association, and the National Retail Federation. Among us, we speak directly with many of your constituents every week.

I believe we have a pretty good idea as to what consumers want and expect out of consumer electronics products in general, and television in particular:

- **Content.** Close to ninety percent of our customers are cable or satellite subscribers, which means they pay to acquire movies, sports, and special programming, as well as news and the prime time lineup. *While much of this hearing will be devoted to devices and technical specifications, we need to keep in mind that what the customer is excited about is access to high quality content.*

- **Value.** With every purchase, the consumer is making a judgment about the value received. We begin with the premise that it is simply un-American to pay too much. Customers also expect consumer electronics products to work predictably and reliably, and *our customers expect to use televisions for a very long time.* They understand that improved products come to market, but they expect that their products will maintain the capabilities they had at the time they were purchased. If the product works today, it had better work the same way tomorrow.

- **Simplicity.** Consumers don't like anything requiring multiple operations if it can be done in one. They want a single remote control and, where possible, a single box. When two mainstream products, DVD players and VCRs, were combined in a single box with a single remote control, the product became so popular last Christmas, we could not keep them on the shelves -- despite the fact that you can't copy movies from the DVD drive to the VCR, and the combination product was more expensive than the two purchased separately. *When confronted by complexity the normal customer reaction is inaction***.**

- **Flexibility.** We do not live in a one-size-fits-all world. Every room in the house may as well be a different household with a different consumer. *The expectations of the 13 inch TV in the kitchen are vastly different from that of the 55 inch TV in the den.* A 27 inch TV serves a different purpose when, a few years after purchase, it is moved from the den to the playroom, where it becomes a secondary viewing location in the household.

Today I am pleased to endorse this Committee's efforts to move the digital television transition forward, and, based on our frontline experience with consumers, to comment on your staff's draft of legislation that would do so. We are very glad and appreciative that this Subcommittee is holding today's hearing; that Chairman Tauzin and ranking Member Dingell of the full Committee have joined you, Mr. Chairman, in holding a series of roundtable meetings on the digital transition; and that the leadership of this Committee has asked us for our comments. We pledge our full cooperation.

What Consumers Are Concerned About

Among your reasons for trying to complete this transition must be the opportunity to put the existing analog broadcast spectrum to other uses as soon as possible. Most consumers are not aware of this objective. *They* support the transition because by now many have seen displays of HDTV. More than three million of them own HD-capable displays, but are still driving them with standard-definition DVD discs and analog broadcast or cable signals. Millions of others have seen the price of the new digital displays come down, but they remain distracted by the questions and concerns I mentioned at the outset:

- **content** -- when and how will I get HDTV over cable?
- **value** -- will the HD-ready product that I buy today hold its value and, at a minimum, operate properly well into the future, or will it be abandoned in the transition?
- **simplicity** -- how do I hook everything up? How many boxes and remote controls will be necessary; will they operate seamlessly together?
- **flexibility** -- can I acquire the right DTV product for my need, as I am accustomed to doing, or will they all have features that I don't need in some rooms, but lack the features I want in other rooms?

Unfortunately, as this Committee is well aware, we are a long way from satisfying these consumer concerns. We know this Committee wants to move forward. So do we. So do our customers.

Moving The Cable DTV Transition Forward Should Be A Top Priority

CERC applauds and endorses the emphasis in the staff legislative draft on achieving "plug and play" nationally portable cable compatibility, and accomplishing this as soon as possible. The staff clearly appreciates that it is only through legitimate and broad competition that we can give consumers the necessary incentive to move the digital transition forward. About seventy percent of our customers are cable subscribers. Yet today, no CERC member can provide them with the products that they want and need. Indeed, *no CERC member is able to offer a consumer a product of any sort that works directly, nationally, and interoperably on digital cable television systems.*

Cable television remains the last bastion of the monopoly distribution of customer premises equipment. Telephones were deregulated in the 1970's, opening the door to, among other things, the Internet. Cable is the *only* high-capacity broadband wire that enters most peoples' homes. Yet, as to receipt of video programming, the proprietary, non-portable, non-interoperable, leased set-top box sits on the landscape as a monolith, blocking out every ray of competition.[1]

[1] About fifty percent of our cable subscriber customers choose not to lease a set-top box -- some because they don't need the extra services; others because they engender confusion, complexity, and expense.

The Long Struggle For Cable Competition

In the late 1950s, cable industry pioneers saw that there was a potential business in supplying consumers with higher value programming, such as movies and non-broadcast channels. To be able to charge the consumer separately for this more expensive programming, they had to assure that they would be paid separately for providing it. Therefore they started *scrambling* some of their channels, and building so-called "addressable descramblers" into the converter boxes that they continue to rent to their subscribers.[2] They insisted, for security purposes, on hard-wiring the descrambling circuitry into the box, to try to avoid theft of service. Thus, their monopoly on addressable set-top boxes -- known later as "conditional access" devices, or "navigation devices" -- was an outgrowth of their *own vulnerability, and the failure of anyone to devise a feasible security alternative.*

Times changed, but, over the next five decades, the cable monopoly did not. Television tuners were upgraded to tune all channels. The telephone monopoly was dismantled as to services and devices. The personal computer and the Internet were invented. Competitive markets were developed as to every other consumer device that acquires or receives information, communications, or entertainment. But because, in the cable set-top box, five percent of the product controls access, the other ninety-five percent has remained immune from competition. And two suppliers control about ninety-five percent of the market.

[2] Originally, the purpose of converter boxes was to enhance the limited tuning ranges and features of some televisions.

Senator Leahy brought this situation to the attention of the Congress in 1991. The Cable Act of 1992 instructed the FCC to work on achieving competitive entry into the markets for both set-top boxes and their remote controls (which were then also monopolized by the cable industry). This was still the analog era, however, and inter-industry attempts at devising a security alternative for the set-top box did not succeed.

In 1995, as the DTV transition approached, this Committee acted clearly and decisively in crafting legislation that was ultimately included in the Telecommunications Act of 1996. Then-Chairman Bliley and Rep. Markey drafted a provision that instructs the FCC in its regulations to *assure* the competitive availability of "navigation devices" from manufacturers and retail vendors that are not affiliated with any Multichannel Video Programming Distributor. Recognizing that this job would entail new technical standards, the law instructed the FCC to draw on the resources of recognized standards-setting organizations.

Some in the cable industry told the FCC that they should be allowed to comply merely by locating second sources for the manufacture of existing converter boxes, and authorizing one additional channel for selling or leasing proprietary, system-specific boxes. Fortunately, the FCC realized that this approach would maintain, rather than deregulate, the monopoly on cable devices. Instead, the Commission decided that only new technical standards, separating the "conditional access" function from other cable navigation functions, would comply with Congress's intention to foster a competitive market. CableLabs, a

cable industry consortium, offered to devise all necessary standards, and the FCC accepted the offer.[3]

More than four years later, however, no CERC member or other retailer, and no manufacturer, can participate in a competitive consumer market for cable devices. Here is my formulation of a "competitive market" as to cable devices:

> *A market, open to all manufacturers and vendors, for "plug and play" devices that will operate on any cable system in the country in a way that is fully competitive with the devices distributed by the cable operators themselves.*

Judging from the letter from the Chairman and ranking Member of this committee to Chairman Powell,[4] and the staff draft of legislation, I trust this definition is shared by the leadership of this Committee.

This market can and should include HDTV receivers; multi-purpose consumer electronics products such as the combination DVD/VCR; personal computers; and, yes, set-top boxes offered by new competitors.

Why The Struggle For Competition
In Cable Devices Has Not Yet Succeeded

The FCC published its regulations, in its CS Docket 97-80, in June of 1998. Since then, about *twenty-five million* digital cable devices have been acquired for distribution -- *all* by cable service operators. According to cable operators themselves, these proprietary, system-specific set-top boxes have rolled

[3] It is still, however, the official position of the National Cable and Telecommunications Association ("NCTA") that retail distribution of proprietary, system-specific set-top converter boxes would fulfill any and all of their obligations under the existing FCC rules. *See* NCTA *ex parte* filing of June 4, 2002. All FCC filings referred to are in CS Docket No. 97-80 and all will be available on CERC's new web site, www.ceretailers.org.

[4] Letter of July 19, 2002, from Chairman Tauzin and Rep. Dingell to Chairman Powell.

out at the rate of *135,000 per week*. *The competitive score thus far is monopoly 25 million; competition zero.*

What has gone wrong? According to NCTA filings with the FCC, it is all retailers' fault: satisfactory products are available, but every retailer in the United States passed on acquiring them, for greedy and nefarious reasons. This explanation -- that in the world's most competitive market, not a single participant, large or small, CERC member or not, has embraced a product that consumers would find useful and want to buy -- strains common sense and credulity. We have dealt with it fully and repeatedly in several FCC filings.[5]

The actual reason goes far deeper, to a key element that has been missing from the cable industry's interpretation of FCC regulations. CERC believes the core problem is:

> *No cable operator has ever promised to, been required to, or been given any incentive to, rely exclusively on the same technical standards and license that they have undertaken to devise for prospective competitive entrants.*

More history: After the FCC declared that technical standards must be written so as to enable true competition, the Commission focused on the three technical obstacles that CERC members and others had identified:

(1) **Digital transmission.** The local cable systems were in danger of adopting conflicting digital transmission formats, which could have precluded national interoperability.

(2) **Embedded conditional access systems.** Cable operators insisted on distributing the conditional access circuitry themselves. Therefore, it was necessary to concentrate this circuitry on cards or modules, that could be separately furnished by each operator. *A common, national security interface would be needed to accept these locally provided modules.*

[5] *See, e.g.,* CERC *ex parte* filing of August 1, 2002, and previous CERC filings cited therein.

(3) **Headend support.** Cable "headends" (which control signal distribution and activate interoperable features) had been configured to support only locally procured devices. A competitive national market in interoperable devices would require that equal means of *support for competitive devices be implemented in all cable headends.*

Obstacle (1) was solved in the standards world, as the MPEG family of standards emerged into common usage. Obstacles (2) and (3), however, still loom over the landscape. Progress has been made recently, but ultimate success is still not assured.

In its *Report & Order* of June 24, 1998, the FCC set two dates by which hallmarks of support for competitive entrant products were supposed to be achieved by cable operators, or they could lose the right to distribute their own leased devices:

July 1, 2000, for cable operators to furnish security ("Point Of Deployment," or "POD") modules for competitive entrant devices, and to support the operation of the competitive devices on their systems; and

January 1, 2005, for operators to rely themselves on the national security interface in the products that they distribute. (The FCC saw, presciently, that a technology not relied upon by its developer may not be adequately supported by that developer.)

Consumer electronics manufacturers and retailers, in reconsideration petitions, told the FCC that the 2005 date was too far in the future to compel meaningful reliance by cable operators or CableLabs. We urged that this date be moved up to 2001. In its *Reconsideration Order* of May 14, 1999, the FCC declined to do so, but observed that *if competition had not bloomed by the year 2000, the Commission would hold a review, and might move the 2005 date up to 2003.*

The 1998 *Report & Order* also failed to specify the *level of support* that must be afforded competitive devices, either in the device specifications themselves, or at the cable headend.[6] The NCTA and CableLabs have taken the position that while consumers have a *right to attach* competitive devices to their systems, they do *not* have a right to expect reasonable, competitive, and interoperable performance of these devices. In fact, CableLabs has declared that national portability via the OCAP specification (or otherwise) is *not* a legal or regulatory requirement. This statement can still be found on the CableLabs "OpenCable" web page.[7]

Given the lack of either mandated technical specifications *or* any requirement that cable operators rely themselves on whatever they develop for use by competitive entrants, what happened seems, in retrospect, all too predictable:

- Technical specifications to support even rudimentary cable products, not nationally portable as to key features (and hence not competitive with existing, operator-provided set-top boxes), were developed far too late for competitive manufacturers to develop any product whatsoever by July 1, 2000

- Technical specifications that *would* support nationally competitive products have not neared completion until recently. Still, however, there has not been a single pledge from a cable operator to rely exclusively on these specifications in its *own* products. Nor has there been any date certain promised as to when entrant products would be supported, adequately or otherwise, by any cable system *headend*.

- Attempts by entrant manufacturers to develop interim specifications for DTV and HDTV receivers that work on cable -- even in ways not fully competitive with existing set-top boxes -- have bogged down in disputes over product standards, testing, certification, and licensing. *In our view, most of these disputes could have been avoided had cable operators pledged, or been*

[6] The *Report & Order* stressed the importance of nationally portable operation of devices if a truly competitive market, that embraced products such as HDTV receivers, was to be supported. But it also said that it was not, at that time, prescribing any *specific* requirements for achieving national portability.

[7] *See* www.opencable.com/ocap.html and NCTA *ex parte* filing of June 4, 2002.

required to, rely on the same specifications and license provisions that they provide to the entrant manufacturers.

- The 1996 Telecommunications Act has been interpreted as allowing a subsidy to the deployment of digital cable devices, based on revenues from the rental of existing analog set-top boxes. A subscriber that chooses a competitive device in preference to a leased, proprietary one would lose the benefit of this subsidy. *Not a single MSO has offered to extend this benefit to their own subscribers who choose competitive devices.*[8]

In summary, six and one half years after Congress acted, there has yet to be a single POD-reliant product introduced into the marketplace, either by any CERC member or by any of the retailers that are not CERC members.

What CERC Has Proposed To The FCC

In September, 2000, the FCC opened its "Year 2000 Review" as to what else the Commission needs to do. Even before the commencement of this review, CERC proposed to the Commission a direct and simple approach that would rely on marketplace incentives, rather than on intense regulation, to accomplish Congress's objectives. CERC proposed, and continues to advocate, a single, simple addition to the Commission rules:

> 76.1204(a)(1)… **Commencing on [July 1, 2003], any multichannel video programming distributor subject to this section, or affiliate thereof, shall place in service for sale, lease, or use only such new navigation devices as rely, for their operation, solely on whatever OpenCable specifications and licensing terms, to implement services, features, applications, and conditional access support, as are required by the distributor with respect to the licensing, manufacture, certification, attachment or use of navigation devices provided by unaffiliated manufacturers or vendors pursuant to Section 76.1201.**[9]

[8] In fact, NCTA has cited the fact that CERC has raised this issue, on behalf of NCTA's own members' cable subscribers, as "proof" the retailers are not interested in a competitive market unless they can capture this subsidy themselves! *See, e.g.*, NCTA *ex parte* filing of June 4, 2002.

[9] CERC members first made this proposal in an *ex parte* letter of April 16, 2001, with a proposed compliance date of January 1, 2002. CERC now proposes a compliance date of July 1, 2003.

Lessons From Our Efforts Thus Far

While consumer electronics manufacturers and retailers have filed paper after paper with the FCC, we have seen approximately $10 billion in commerce evade the competition that Congress ordered in 1996. In this period I think we have all learned that support for competitive devices is as much a matter of *economics, self-interest, and incentives,* as it is one of regulation:

- If a developer of a technical specification does not contemplate distributing reliant products himself, the quality, reliability and efficiency of products made to that specification will be assigned a lower priority by the developer.
- If the standard or product in question is competitive with the developer's own product, these attributes will be assigned a still lower priority.
- A system operator will care primarily about supporting the products he distributes himself, rather than those of competitive entrants, unless given an incentive to the contrary.

These three factors explain a lot:

- Why, after ten years, not a single cable headend is equipped to support the standards developed for competitive entrants.
- Why not a single cable operator has made an unconditional pledge to support these standards.[10]
- Why detailed and prescriptive regulations -- trying to *force* cable operators to support technologies they don't intend to rely on themselves -- invite further frustration and controversy.

CERC also proposes a regulation as to subsidy practices. CERC's full proposal is reproduced as an Appendix to this statement.

[10] In cases of both the "POD" module and the "OCAP" standard, statements by some cable MSOs have pledged support when reliant products are on the market. This proved a "Catch-22" as to PODs, because entrant development of POD-reliant products has not been adequately supported in the first place. Similarly, an HDTV manufacturer is not likely to offer consumers a $5,000 OCAP-reliant product if major cable headends are still years away from supporting OCAP -- so the "pledge" would never have to be honored.

Crucial Items That Still Must Be Addressed:
The "OpenCable Access Platform" ("OCAP"),
The "POD-Host Interface License Agreement" ("PHILA"),
POD Reliance And Cost

Despite all these delays and problems, we are at the point where several key technologies have, in fact, become industry standards. The "OCAP" technical specification -- the best hope for products that are nationally portable yet fully competitive with devices designed for individual systems -- may also finally be nearing completion. In our view, on behalf of our willing but anxious customers, there are three crucial issues yet to be resolved, on which we urge this Committee to focus its legislative and oversight attention:

Headend Support. You can have the most sophisticated consumer devices, and the most sophisticated cable headends, but if they are not designed to interoperate, the consumer is the loser. At present, cable headends are designed to support 25 million proprietary, system-specific set-top boxes, rather than competitive products. *Some* cable operators are recognizing that migrating to a common "middleware" platform, such as "OCAP," may be in their own long-term interests, as well as that of their subscribers. But unless *all* cable headends make this migration by a date certain, this Committee's efforts to support products that are both competitive and nationally portable will continue to fail.

In my view, it will be in manufacturers' interest to offer OCAP functionality when (1) OCAP will work reliably in consumer products when supported at the cable headend, and (2) OCAP is in fact supported by all cable headends. These objectives -- technical reliability and operator support -- will be

accomplished *only* when the devices that cable operators distribute *themselves* must also rely exclusively on OCAP.

The "PHILA" License. Competitive entrants have been frustrated in their attempts to procure a license for "POD" security modules *without* having to agree to a passel of provisions that would impose serious burdens on consumer use of display and recording products, and other provisions that seem at variance with FCC regulations. Chairman Tauzin and Rep. Dingell made a tremendous contribution by simply demanding that this draft license be taken out from under non-disclosure agreements, and aired publicly. Recently, Rep. Boucher wrote to Chairman Powell, proposing that competitive entrants provide the FCC with a version of the PHILA license that does comply with FCC regulations, and does not harm or burden consumer use of present and future products. He also proposed that the FCC then oversee negotiations on an expedited basis. Two weeks ago, CEA filed such a draft license with the FCC.[11] We are very hopeful that negotiations will succeed on this basis.

"**POD" Cost And Support.** Although the cable industry has been specifically aware of the need for a national security interface since 1998, in the last few months it has filed documents with the FCC claiming that each module and interface, together, would cost almost $100, and asking to be excused from compliance as to their own products. CERC responded that the cost complaint is a self-fulfilling prophecy, because the industry has resisted manufacture in any volume. We filed supporting documentation to show that, at cable industry

[11] *See* CEA *ex parte* filing of Sept. 11, 2002.

deployment rates, after a few months the price would drop to under $15, and keep dropping.

Again, the issue here is one of *reliance*. If cable operators never have to rely on PODs but their competitors do, where is the market incentive to make them operate better and cost less? If only competitive entrants use PODs, how long will it take to reach one million units of production? As in the case of OCAP, incentives work better than regulation. *You can't reasonably **order** costs to go down* when the volume isn't there to support the reduction. You can order "full support" for poorly or inefficiently engineered products, but enforcing your order is, and has been, a nightmare.

> *What you can, and should, do is tell the cable operators simply that what's good enough for their competitors is good enough for them.*[12]

It seems ironic that the FCC has now (in the "dual tuner" order) ordered all TV manufacturers essentially to build a computer into their products, and expects volume production to bring costs down from the hundreds to the tens of dollars. Yet the benefits of volume production are ignored by the cable industry as to a far simpler device -- one as to which it has already been demonstrated around the world that mass production can bring the price down to single digits in a year or two.[13]

---

[12] FCC regulations do this, although the 2005 date is too far in the future. CERC respectfully and strongly disagrees with the staff draft provision that would remove this regulation.

[13] *See* CERC *ex parte* filing, August 15, 2002, Declaration of Jack W. Chaney. At the deployment rate of 135,000 per week, the volume milestone of one million units would be reached in less than 2 months. Reaching this volume level based on competitive entrant products alone would, unfortunately, take much, much longer.

Specific CERC Comments
On The Staff Draft Of H.R. ----

Much of the staff legislative draft on which you have invited comment today is music to our ears, but we think the words still need some work. We would be pleased to join with other interested parties to work with the staff on fine tuning. As I have concentrated on the "cable compatibility" issue today, I will address that section first, though we do have comments on some of the other sections, as well.

"Digital Television Cable Compatibility."

The goals stated and implied in this provision provide a strong step forward. We applaud the Committee for recognizing that cable compatibility is a key -- perhaps *the* key -- to the digital transition. The Committee staff also recognizes that it involves support for multi-purpose consumer electronics products, as well as for DTV and HDTV receivers.

While consumer enjoyment of digital television is the ultimate goal of cable compatibility, achieving this goal for consumers involves compatibility of more than the DTV receiver itself. Just as telephone deregulation helped spawn many new products (modems) and services (the Internet) that are not telephones, true cable compatibility can enhance, even create, entire new generations of products that are not DTV receivers. The draft recognizes this, but not in enough places. Today I can only touch on the particulars of our concerns, and how we think they might be addressed.

- **"Nationwide interoperability and portability**." This specific requirement and expectation is long overdue. Emphasis on receiving, recording, and display devices is very welcome.
- **"Uniform family of technical standards**." With respect to PHILA, we think it is a step forward to distinguish, as this provision does, between specifications controlled by CableLabs, and uniform standards, that are not. However, we are concerned that in present form (d)(2) appears very prescriptive as to technology that is less than leading edge; pertains primarily to DTV receivers but not the other products cited in (d)(1); and does not mention OCAP.

We understand some of the reasons for focusing here on near-term solutions. Manufacturers do not wish to be subject to legal mandates as to which features to offer to consumers. But, as I discuss above, this cannot be the end of the story. For more advanced services (that are already offered in proprietary set-top boxes) to be supported as to competitive entrants, there must be some *incentive* for cable operators to support these products. Rather than try to achieve support for these advanced services by strict mandate, yet avoiding oppressing manufacturers, we recommend the CERC solution: **a simple requirement that cable operators' products must also rely exclusively on the technologies that they develop for their competitors**.

- **POD Modules**. Paragraph (2)(B) mandates, by July, 2005, standardization of POD modules that has in fact already been achieved, without requiring any improvements. Section 10 of the bill, which would eliminate cable operator deployment of the national security interface in their own devices, goes in the wrong direction, for the reasons I've pointed out above. It would remove incentives for (1) improvement of POD modules, and (2) dramatic decreases in cost, and improvement in efficiency, through immediate mass production and deployment.

  In theory, it should not matter to competitive entrants and retailers whether the cable operator set-top requires a POD module, because the cost of the module is a network cost that they must bear. But look at the economic incentives: already, it is a device to support competitors; how good should cable operators and their entrenched suppliers want to make it? The change wrought by Section 10 would also ensure that for years, this device would remain in low volumes, as competitive entrants battled their way into the market. Operators and CableLabs would have every incentive to keep efficiency, reliability and volumes low.

  In its Reconsideration Order, the FCC recognized that this kind of foot-dragging could occur, and said that if it did, it would consider moving *up* the reliance date, to 2003. That is what the Commission should do. Therefore, if we hope to avoid more years of endless debate over standards and move toward real and legitimate competition, and if we hope ever to see cable functionality integrated into television sets, Section 10 must be omitted.

♦ **Equipment compliance with standards**. Having mandated specific technical standards, the draft would first impose compliance obligations on manufacturers, then list exemptions. If adequate incentives or regulations exist as to cable support, a specific mandate on manufacturers should not be necessary.

The "exemptions" from the mandate clearly are meant to be *restrictions as to obligations that can be imposed on manufacturers via the PHILA license.* As such, they are vitally pro-consumer, very well founded, and should help resolve outstanding PHILA issues:

- allowing manufacturer self-certification;
- robustness and compliance rules that do not impair functionality of consumers' reception, recording, and display equipment (ruling out, *e.g.*, "selectable output control" and "downresolution");
- limitation to provisions that address only theft of service and physical harm to the network (rather than cable operator business objectives or market advantage); and
- that OCAP implementation need not be mandatory with manufacturers, as not all consumers will need this facility built into their TV receivers.

Some elements that we think should be included, or more clearly stated:

- While there is some reference to "encoding rules," to protect consumer expectations as to the viewing resolution and ability to record received content, the requirement of such rules in license or regulation should be more explicit, adopting for digital television the provisions of Section 1201(k) of the Digital Millennium Copyright Act of 1998 ("DMCA").
- Based on our experience with consumer expectations, manufacturers need some assurance that their products will have adequate access to *electronic program guide* information, without forcing the consumer to pay twice for the receipt of this information.

Generally, this important "exemption" provision would be clearer if stated primarily in terms of what terms *cable operators* may not impose via *license*, rather than in terms of what the *regulations* may mandate. Imposition by license is the real issue at hand.

- **Upgradeable to successor digital interfaces**. While this requirement is a laudable goal, I see several potential problems in terms of the core consumer concerns I described at the outset:

(1) **value** -- manufacturers today cannot know what "successor" systems will be or entail, so they cannot within any reasonable cost ensure "upgradeability" to unknown, or even to some known, systems.

(2) **flexibility** -- this requirement, even if achievable, may not be necessary for some or many products meeting the staff's definition of "television display."[14]

(3) **content** -- the only way I can imagine meeting this requirement would be through some plug-in involving digital-to-analog-to-digital ("D-A-D") conversion. In addition to degrading the signal, it would likely be considered insecure by content providers. Any purely digital means for providing a secure "handshake" with an unknown system, even if feasible, would likely require extensive multi-industry technical standards discussions as to preserving signal security from one system to another, possibly *delaying* the entry of any new display products, or any new digital protection technologies, into the market.

[14] This term, not defined in the staff draft, is, I believe, not found in statute or regulation. These refer to a "television receiver," which has an off-air tuner. Television-capable displays would seem to include all computer monitors, and, nowadays, many PDAs, mobile telephones, and other products.

Digital Television Broadcast Flag Rulemaking

As I noted at the outset, a core consumer concern that drives the acquisition of new products is to receive compelling content for enjoyment at home. Therefore, CERC members endorse the goal of the "broadcast flag" initiative, which is, I believe, correctly stated in the staff draft: to curb the *unauthorized redistribution to the public of content over the Internet*, in competition with the original authorized distributor.

We also endorse the other core goal of the draft, which is to do this *without* depriving consumers of the functionality of any of the products already in their home, or on their home network. Accomplishing *both* of these core goals -- as the private sector Broadcast Protection Discussion Group ("BPDG") participants found in six months of discussion -- is no easy task. Some of these complications are evident in the staff draft as well.

One provision that we think simply does not work, and poses (depending on how it is interpreted or applied) unacceptable hardship for *either* consumers or content providers, is the provision in Section 5(b)(3), that would "terminate the manufacture of equipment [capable of demodulating DTV broadcasts] that has analog outputs by July 1, 2005." Depending on how interpreted or enforced, it seems that this provision would either (1) largely destroy the utility of 300 million TVs and VCRs, plus millions of PCs and their displays, already in consumers' homes, *or* (2) create a huge market for D/A converters, necessary to fulfill the *other* laudable obligations of this Section -- that the utility of devices already in consumers' homes be preserved. Moreover, content providers would likely regard

such cheap and prolific D/A converters as "circumvention devices." At present I see no way of saving this provision from one or the other consequence. Our specific comments:

- **(b) regulation requirements, criteria**. We endorse the ideas of an expedited process, self-certification, and objective criteria. We endorse the goals of (B), that regulations not impose unnecessary or unreasonable product burdens, (C) that they protect full functionality of earlier consumer equipment, and (D), that they provide for technological and market neutrality.

We understand, however, that in BPDG discussions, many felt that goal (b)(C) (protecting all possible functions of products already in the home) could not feasibly be satisfied while still meeting goal (a) (preventing the unauthorized redistribution to the public). In such case, I fall back on my description, at the outset, of core consumer requirements: that legitimate consumer expectations *at the time of purchase* of the product must be protected. Application of this principle means, in my opinion:

1. As to display devices, not constraining the availability of, or downgrading the resolution of, signals in formats for which the display has inputs.[15]
2. As to recording devices, not constraining reasonable and customary consumer expectations as to recording through the device's inputs.
3. As to playback devices, not constraining the ability to play back programs according to consumer expectations as to formats existing at the time of purchase.

For any "broadcast flag" implementation to be accepted rather than resisted by consumers, these must be considered immutable concerns.

[15] This implies *not* cutting off or degrading any inputs to these products, including the analog inputs -- which for most existing products, is all they have.

- **(b)(3), termination of analog outputs**. If this provision means what it seems to mean, it would impose unacceptable hardship on consumers, at variance with principle 1., above. This provision seems to say -- notwithstanding the obligation that functions of in-home devices be protected -- that no device with a DTV tuner may output an analog signal of any sort -- not on channel 3, not via composite, component, or "S" video -- after July 1, 2005.

This provision seems to say that the 300 million TVs and VCRs in consumers' homes -- including the 3 million HD-ready displays recently purchased by DTV transition pioneers -- could no longer acquire *any* broadcast signal off the air, or through a DTV broadcast converter, after January 1, 2006. Even in homes served by cable or satellite services, some televisions are not hooked up to such services, so upon return of spectrum would have no way, other than through a DTV broadcast converter, to acquire signals. Even those existing sets that are hooked up to cable and satellite service have no digital inputs, and most have no integrated DTV tuner, so must rely on *some* analog input from an external device. The same is true as to the hundreds of millions of PC monitors in use today, which would rely on tuner cards in PCs.

Presumably -- though this is not entirely clear -- this provision applies only to outputs of products that themselves contain DTV broadcast demodulators, and not to outputs of products that receive flag-protected signals from DTV tuners by digital means. Therefore, relying on the requirements stated in (b)(2), requiring protection of the full functionality of devices already in the home, one can assume that digital protection technology systems, such as DTCP, HTCP,

and others, would be *required* to provide analog outputs serving every analog input in the marketplace on January 1, 2006 -- component, composite, "S," and "RF" video -- at all resolutions for which devices in homes today have inputs. One must also assume that cable and satellite set-top boxes carrying flag-protected signals would also be obliged to offer all of these analog outputs. This interpretation is essential to avoid turning 300 million TVs and VCRs, and most existing PC monitors, into useless furniture. The problem with it, however, is:

- Consumers would, even so, be obliged either to subscribe to cable or satellite, *or* to buy an add-on converter, in addition to the add-on DTV tuner, to support an existing TV, VCR, or PC monitor.[16]

- Content providers would likely regard the millions of D/A converters that support all analog outputs in all resolutions as potential "circumvention devices," as to other protections built into the secure digital transmission systems.

Alternatively, subsection (3) could be read as outlawing *any* analog output, in *any* product capable of receiving, converting, or carrying a flag-protected signal. This would include cable boxes, satellite boxes, and add-on D/A converters. This interpretation would mean that the hundreds of millions of TVs, VCRs, and PC monitors in homes today would become entirely useless as to *any* broadcast, cable, or satellite programming -- broadcast, pay cable, pay-per-view, video-on-demand, etc. We doubt that, given the regard otherwise shown for consumer products and expectations, this is a result intended by the Committee staff.

- **(b)(5), safeguards**. CERC endorses this provision. But see above.

[16] This existing product may still provide vital service to the home, but be worth less than the value of the two add-on converters.

Digital Television Tuner Requirements

CERC has not taken a position on the FCC's order as to "dual tuner" requirements, *per se*. However, CERC agrees with and endorses the observations of several FCC Commissioners, the Media Bureau staff, and Members of Congress that the public interest is served by this requirement if nationally portable and interoperable cable tuners can be deployed in all affected products on at least the same deployment schedule. My own estimation is that this would require:

- immediate product planning by manufacturers, and,
- resolution of the outstanding compatibility, regulatory, and license issues, that I have discussed, within an accelerated time frame.

CERC has stressed that incentives, efficiency, and consumer expectations are the key to breaking through the barriers to the digital transition. It is widely accepted that, whereas the dual tuner obligation serves primarily the 10 - 15% of households that do not have cable or satellite access, the components necessary to implement this obligation are largely the same ones that can support operation of these television receivers as nationally portable and interoperable DTV cable navigation devices. It would ill-serve consumers to miss this opportunity.

Pass-Through of Network Digital Signals

We agree with the staff draft that consumers are entitled to receive, from local broadcasters, content that was originated as HDTV. We think, however, that the same obligation, for the same reasons, should apply to local cable operators, with respect to (1) all broadcasts, and (2) non-broadcast, nationally distributed cable channels or programs.

Consumer Notice Requirement

We agree in principle that (1) consumers should not be disappointed in their reasonable expectations as to products already in their homes, and (2) to the extent they are about to be disappointed in a purchase, they should be forewarned. We have concerns, however, about the labeling scheme laid out in the staff draft.

First, quality control should mean doing it right the first time, not trying to fix it later. If the FCC does its job right in implementing regulations, it should not be necessary to have labels about what works with what. Second, requiring labels on *both* media and devices invites hopeless confusion. The consumer risks being trapped in a circle of warnings that, ultimately, makes no sense.

Third, the labeling requirement on equipment seems a moving target. At the time of manufacture, one cannot hope to keep up with all developments in media deployment -- particularly if discretion remains with local cable companies. Updating labels could become a weekly, local, and futile job for retailers.

Finally, it may be counter-productive to require labels on, for example, movies, as to the devices they will play on and the ones they won't. There's only one *Lion King*. The media label that is meant to embarrass the producers, as to which home device is locked out of enjoying the *The Lion King,* would simply depress the market for the device on which *The Lion King* does not play. So, perversely, the labeling imposition on content providers could in fact *empower* them to drive certain consumer electronics and computer devices off the market.

We think initial quality control, guiding the FCC to enact fair and balanced regulations, that respect the consumer and provide appropriate marketplace incentives for content providers, content distributors, and device manufacturers and vendors, is superior to any *ad hoc* labeling patch.

* * *

On behalf of Best Buy, Circuit City, Good Guys, RadioShack, Sears, Tweeter, Ultimate Electronics, the International Mass Retail Association, the North American Retailer Dealers Association, and the National Retail Federation, I would like to thank the Subcommittee for inviting us here today, and congratulate the leadership of this Committee for everything it has done to move this transition forward on behalf of the consuming public. CERC pledges its full cooperation in your efforts.

Appendix

Regulation Revisions First Proposed By CERC members, April 16, 2001

additions in **bold**
deletions in [brackets]

76.1204(a)(1). A multichannel video programming distributor that utilizes navigation devices to perform conditional access functions shall make available equipment that incorporates only the conditional access functions of such devices. Commencing on January 1, [2005] **2002**, no multichannel video programming distributor subject to this section shall place in service new navigation devices for sale, lease, or use that perform both conditional access and other functions in a single integrated device. **Commencing on January 1, 2002, any multichannel video programming distributor subject to this section, or affiliate thereof, shall place in service for sale, lease, or use only such new navigation devices as rely, for their operation, solely on whatever OpenCable specifications and licensing terms, to implement services, features, applications, and conditional access support, as are required by the distributor with respect to the licensing, manufacture, certification, attachment or use of navigation devices provided by unaffiliated manufacturers or vendors pursuant to Section 76.1201.**

76.1204 Availability of equipment performing conditional access or security functions.

(g) Effective January 1, 2002 and until the regulations adopted under this subpart cease to apply as determined in accordance with Section 76.1208, cable system operators must:

(1) provide annual written notification to their subscribers that subscribers may purchase or lease navigation devices from unaffiliated vendors that are capable of receiving the same services, content, programming, features and functions accessible through navigation devices provided by the subscriber's cable system operator, without the need for any additional equipment from the cable system operator and without degrading the ease of use of such navigation devices or the quality of such services, content, programming, features and functions;

(2) provide oral notification and written confirmation, at the time when a subscriber orders cable television or related services, that the subscriber may (A) already own consumer electronics equipment that is capable of receiving the same services, content, programming, features and functions accessible through navigation devices provided by the subscriber's cable system operator, without the need for any additional equipment from the cable system operator and without degrading the ease of use of such

navigation devices or the quality of such services, content, programming, features and functions; and (B) purchase or lease navigation devices from unaffiliated vendors that are capable of receiving the same services, content, programming, features and functions accessible through navigation devices provided by the subscriber's cable system operator, without the need for any additional equipment from the cable system operator and without degrading the ease of use of such navigation devices or the quality of such services, content, programming, features and functions; and,

(3) The notification and confirmation required by subsections (g)(1) and (2) shall indicate clearly that the conditional access function equipment required to access certain services, content, programming, features and functions using a navigation device purchased or leased from an unaffiliated vendor is the same as the one required for navigation devices provided by the cable system operator, and that the price for such conditional access function equipment is identical regardless of the subscriber's choice.

76.1206 Equipment sale or lease charge subsidy prohibition.

(a)(1) Multichannel video programming distributors offering navigation devices subject to the provisions of Section 76.923 for sale or lease directly to subscribers [shall adhere to the standards reflected therein relating to rates for equipment and installation and shall separately state the charges to consumers for such services and equipment] **shall not use any service revenues to subsidize the sale or lease prices or rates of these navigation devices until the regulations adopted under this subpart cease to apply as determined in accordance with Section 76.1208.**

(2) Effective January 1, 2002, a Multichannel video programming distributor offering navigation devices subject to the provisions of subsection 76.923 may elect to pool the costs of devices covered by subsection 76.1204(a)(1) with the costs of all other navigation devices provided by the MVPD if it:

(A) maintains on its publicly accessible web site and files with the Commission and the applicable franchise authority a report disclosing:

(i) the price or prices for each navigation device offered by such multichannel video programming distributor;

(ii) the amount of any subsidy reflected in the price for each such navigation device, and

(iii) the methodology by which such subsidy was calculated; and

(B) provides to subscribers the same subsidy for navigation devices purchased or leased from unaffiliated vendors as that reflected in the price for navigation devices provided by such multi-channel video programming distributor.

(3) The report described in subsection 76.1026(a)(2)(A) shall be amended within ten days of the offering of any new navigation device or any revision in the price or terms for any existing navigation device. The Commission may review and direct changes in the methodology described in subsection 76.1206(a)(2)(A)(iii).

(b) The requirements in subsections (a)(2) and (3) shall remain in effect until the regulations adopted under this subpart cease to apply as determined in accordance with Section 76.1208.