

New Jersey Board Of Public Utilities

**REPORT TO THE GOVERNOR AND LEGISLATURE**

***THE STATUS OF  
MULTI-CHANNEL VIDEO COMPETITION  
IN NEW JERSEY***

PUBLIC LAW 2003, Chapter 38

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**GLOSSARY**

- Bandwidth:** A range of frequencies in the broadcast spectrum that is occupied by a signal. (For example, a television channel may have a bandwidth of 6 MHz.) The "necessary bandwidth" is the amount of spectrum required to transmit the signal without distortion or loss of information. Commission rules require suppression of the signal outside the band to prevent interference.
- Broadband:** Broadband is a descriptive term for evolving digital technologies offering consumers a single switched facility with integrated access to voice, high-speed data services, video-demand services and interactive information delivery services. Broadband also is used to define an analog transmission technique for data or video that provides multiple channels. A cable TV system, for example, employs analog broadband transmission. (See Bandwidth).
- BSP:** Broadband Service Providers – carriers utilizing transmission facilities, usually coaxial cable, that have a bandwidth (capacity) greater than a voice grade line of 3 kHz. These facilities may carry numerous voice, video and data channels simultaneously with each channel using a different frequency on the cable.
- CATV:** Cable Television – A service through which subscribers pay to have local television stations and additional programs brought into their homes from a distribution source via a coaxial cable.
- CLEC:** Competitive Local Exchange Carrier – A company certified to offer local telephone service in competition with the regional Bell companies and other incumbent telephone carriers.
- Coaxial Cable:** A type of cable, commonly used in cable television systems, composed of two concentric conductors: an inner wire and an outer braided sleeve.
- Common Carrier:** A quasi-public provider of services to the public at large. A telephone company is a common carrier; a cable company is not.
- Clustering:** A strategy employed by cable companies to concentrate or increase the size of their cable system properties in key markets. The goal of clustering is to gain economies of scale in local markets to best leverage capital expenditures and maximize operating efficiencies, service deployment and marketing.
- DBS:** Direct Broadcast Satellite (Small Dish) – A TV broadcast service from a small satellite dish antenna that offers services similar to cable TV, and which transmits highly compressed digital signals.
- DSL:** Digital Subscriber Line – (also ADSL, VDSL) – A modem technology that provides greater bandwidth from ordinary telephone lines.

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<b>DTV:</b>	Digital Television – Television signals transmitted and received in digital format using electrical or electromagnetic signals that can be modulated to convey specific content. The TV picture is often in the same ratio as movie screens and may have up to 1,080 lines of resolution, producing a crisper picture.
<b>Enhanced Service Providers:</b>	A company that transmits data messages and simultaneously adds value to the message it transmits. Examples include telephone answering services, alarm/security companies and transaction processing companies.
<b>Facilities-Based Telecom Company:</b>	A telecommunication carrier that owns call switching equipment and transmission lines.
<b>FCC:</b>	Established by the Communications Act of 1934, the Federal Communications Commission is the federal agency in charge of overseeing interstate telecommunications as well as all communications services originating and terminating in the United States.
<b>Federal Preemption:</b>	A legal theory triggered when the United States Constitution or Congress expressly provide exclusive power to the Federal government in a particular field and supplant state authority; or when the Federal intention to do so may be inferred from a pervasive system of regulation which does not leave a sufficient vacancy within which the state can act. A state may not pass any law inconsistent with the federal law when pre-emption controls.
<b>Fiber Optics:</b>	A method for the transmission of information (sound, video, data) in which light is modulated and transmitted over high purity, hair-thin filaments of glass. The bandwidth capacity of fiber optic cable is much greater than that of copper wire.
<b>FTC:</b>	The Federal Trade Commission is an agency of the Federal government created in 1914, whose principal functions are to promote free and fair competition in interstate commerce through prevention of general trade constraints, such as price-fixing agreements, false advertising, illegal combination of competitors, and other unfair methods of competition.
<b>FTTH:</b>	Fiber to the Home refers to the installation of fiber optic wires in the “last mile” between the telephone central office and the home.
<b>Hertz (Hz):</b>	A unit of frequency commonly used to measure speeds of transmissions equal to one cycle per second (cps); One kilohertz (kHz) equals 1000 cps; one megahertz (mHz) equals 1 million cps; one gigahertz (GHz) equals 1 billion cps.
<b>HSD:</b>	Home Satellite Dish (Large Dish) – A home receiver that permits the consumer to receive existing satellite transmissions.
<b>ILEC:</b>	Incumbent Local Exchange Carrier – a term used to refer to the Regional Bell Operating Companies (RBOCs) who provide local exchange service.

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<b>Internet:</b>	A worldwide computer network that links the user to businesses, government agencies, universities, and individuals. The Internet provides computers with the ability to connect with other computers for communicating, disseminating and collecting information.
<b>Interoperability:</b>	The ability of software and hardware from multiple vendors to communicate effectively; the ability of systems or units to provide, accept and use services from other systems or units.
<b>ITFS:</b>	Instructional Television Fixed Service – A service provided by one or more fixed microwave stations operated by an educational organization and used to transmit instructional information to fixed locations.
<b>IXC:</b>	Interexchange Carrier – A long distance telephone company linking separate local exchanges.
<b>kHz:</b>	Kilohertz – see Hertz (Hz).
<b>LMDS:</b>	Local Multipoint Distribution System – A wireless cable system that enable greater upstream bandwidth than most other wireless services from a fixed station for entertainment video and CLEC services.
<b>Modem:</b>	An abbreviated term for “modulator de-modulator.” A modem converts digital signals into analog signals (and vice versa), enabling computers to send and receive data over traditional telephone networks.
<b>MMDS:</b>	Multi-channel Multipoint Distribution System – A wireless cable service using microwaves to transmit multiple television signals to customers.
<b>MSO:</b>	Multiple System Operator – A major cable TV organization that has franchises in multiple states.
<b>OCTV:</b>	Office of Cable Television – the regulatory arm of the Board of Public Utilities, the franchising authority, certified by the FCC to regulate basic rates, technical standards, and customer service obligations of cable TV operators for the State of New Jersey.
<b>OVS:</b>	Open Video System – similar to a cable system, but in return for less regulatory oversight, the system operator must lease channel capacity to unaffiliated programmers at just, reasonable, and non-discriminatory rates.
<b>PEG:</b>	Public Educational & Governmental Access – channels set aside by a cable operator for use by the public, educational institutions and local governments unaffiliated with the operator.
<b>POTS:</b>	Plain Old Telephone Service – basic telephone service which originates from lines connecting most residential and small business users to the public telephone network.

- PSTN:** Public Switched Telephone Network – the common domestic telecommunications network that is accessed by private branch exchange trunks, telephones and Centrex systems to carry phone calls from end to end.
- RBOC:** Regional Bell Operating Company – (also BOC) – any one of the seven local telephone companies that were created in 1984 as part of the break-up of AT&T: Ameritech (now SBC), Bell Atlantic (now Verizon), Bell South, NYNEX (now Verizon), Pacific Telesis Group (now SBC), Southwestern Bell (now SBC) and U. S. West (now Qwest).
- SMATV:** Satellite Master Antenna Television – small-scale, private cable system using a central rooftop antenna to serve the TV sets in an apartment building, hotel, or multiple dwelling unit.
- Vertical Integration:** The degree to which a firm owns its upstream suppliers and downstream buyers is known as vertical integration. It affects cost, product differentiation, marketing and other strategic issues, and is an important factor in a firm’s strategic and competitive position within an industry.
- UNE:** Unbundled Network Element – components of a telecommunications system that are leased to competing carriers at wholesale rates, including local loops, OSS, and local and tandem switches.
- VDSL:** Very-high bit rate DSL – see DSL.
- VoIP:** Voice over Internet Protocol – a service that allows a user to make telephone calls using an Internet connection instead of a regular phone line.

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## **EXECUTIVE SUMMARY**

While multi-channel video competition is increasingly robust in New Jersey as a result of greater direct broadcast satellite (“DBS”) penetration, competition among cable operators remains stagnant. Over 2.5 million New Jerseyans subscribe to traditional cable television (“CATV”), while 12% of the aggregate multi-channel video subscribers select a DBS company rather than a traditional cable company.<sup>1</sup> Consumers can choose among cable TV, DBS, the Internet, and even MobiTV, a service that offers television viewing on a cell phone.<sup>2</sup> A recent Federal Communications Commission (“FCC”) report found that Americans enjoyed more choice, more programming, and more services than at anytime in our nation’s history.<sup>3</sup> As of June 2003, 94.1 million households subscribed to some form of multi-video channel programming, showing an increase of over 56% in the past 10 years.<sup>4</sup> Moreover, cable television now reaches almost 70.5 million subscribers nationwide.<sup>5</sup>

Despite these varied technology options and the existence of seven cable companies in the State of New Jersey, approximately 92% of the State’s subscription cable customers are served by Comcast or Cablevision.<sup>6</sup> This dominance by two companies - neither of which is in direct “head to head” competition with the other - leads to questions whether New Jersey is a truly competitive market producing the lowest possible prices for its residents.<sup>7</sup>

The New Jersey Board of Public Utilities (“BPU” or “Board”) has focused this Report on the subjects of Public Law 2003, Chapter 38, issues specific to New Jersey as they relate to multi-channel video competition. The law directs the BPU to examine specific areas of video competition, all of which either implicitly or explicitly address the question of the status of multi-channel video competition in New Jersey. Before examining those areas, however, one must consider how New Jersey differs from other states in its regulation of cable television.

New Jersey is a unique state with respect to cable regulation. Normally the duties of the local franchising authority are handled individually by each municipality in which a cable operator seeks to offer service. In New Jersey, however, statutes have placed full regulatory authority over cable television companies with the BPU. Only six other states regulate in a similar manner: Connecticut, Hawaii, New York, Massachusetts, Vermont, and Rhode Island.

Cable operators - including Comcast, the largest operator in the State - have repeatedly acknowledged that New Jersey’s regulatory framework is superior to other states. In response to the FCC’s Inquiry of the Status of Competition, WVT Communications - a competitor to cable television companies - wrote: “The (second) example of regulatory anti-competitive behavior is the delaying tactics employed by the [New York Public Service Commission] and in the approval

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<sup>1</sup> Written comments of the New Jersey Cable Telecommunications Association (“NJCTA”) by Karen Alexander, President, March 8, 2004 at p.4, n.6.

<sup>2</sup> USA Today, February 11, 2004.

<sup>3</sup> *In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, MB Docket No. 03-172, 31 Communications Reg. (P&F) 700, F.C.C., released January 28, 2004 (hereinafter, “*FCC Tenth Annual Report on Video Competition*”).

<sup>4</sup> *Ibid.*

<sup>5</sup> *Ibid.*

<sup>6</sup> Board of Public Utilities, Office of Cable Television, 2004 Cable Facts.

<sup>7</sup> Written comments of Christopher White, New Jersey Division of the Ratepayer Advocate, Public Hearing, In the Matter of the Status of Broadband Telecommunications and Multi-Channel Video Programming Competition in New Jersey, February 26, 2004 (noting absence of choice and competition in cable) at p.3.

process of a Cable TV franchise with a [local exchange carrier]. A comparison of the competitive-friendly nature of the BPU in New Jersey will demonstrate...” Further, WVT states: “The major difference between New York and New Jersey is that New Jersey has taken a positive stance in regards to promoting competition in the video marketplace....”<sup>8</sup>

New Jersey’s hospitable regulatory environment stems from the BPU’s scrutiny of all would-be competitors and the protection it brings for both incumbent cable operators and consumers. Pole attachment agreements, for example, negotiated by the Board, enabled 99% of the State to be wired for cable television service by the late 1980s. The favorable aspects of reporting to one agency - as opposed to 562 franchising authorities and city attorneys - are significant. Chief among those is the BPU’s role as the local franchising authority and ultimate arbiter for disputes between the cable operator and the municipalities.

Centralized jurisdiction also benefits the companies in avoiding the cost of having different rates set for each of the municipalities it serves, and facing different rules governing their operations. Under the current framework, companies set a single rate on a broader system-wide basis. The agency has implemented an optional expedited rate procedure which avoids the need for costly litigation and rewards cable companies with quick resolution of rate cases where little or no increase occurs in the basic rates. Further statutory ground rules for sales, mergers and acquisition give cable operators a more predictable means of financing their ventures.

The expert knowledge of the industry and the single set of laws which govern avoid some of the frivolous litigation cable operators face in other states or the requirement that they abide by different customer service requirements in each municipality they serve. The right to access provided under New Jersey’s statutes also allows cable operators unfettered entry into private communities. Likewise, class action suits, which have been filed in more than half of the states, are avoided with the Board because it has primary jurisdiction over cable company operations.

These benefits make New Jersey an ideal place to provide multi-channel video services – and a rich environment in which to consider the questions posed by the Legislature with respect to competition.

### **Part I--The State Of Competition**

“The state of multi-channel video programming competition between different facilities-based and non-facilities-based telecommunications companies in New Jersey, such as cable television companies, digital broadcast satellite companies, local exchange telecommunications companies and interexchange telecommunications carriers and, in particular, the state of competition in New Jersey among the dominant cable television companies for the same customers”

- Head-to-head competition of cable vs. cable and DBS vs. DBS is less relevant in the eyes of the FCC than all forms of multi-channel competition measured against each other.
- Wireline competition among video providers in New Jersey is sparse. Four towns in New Jersey have some facilities based competition (Paramus/Hillsdale has cable v. cable while West Milford and Vernon has telco v. cable).

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<sup>8</sup>Hometown Online, Response to Notice Of Inquiry Into The Status of Competition in the Marketplace For The Delivery Of Video Programming, FCC CS Docket #02-145 (August 13, 2002).

- Competition to cable in New Jersey and the rest of the country is primarily from DBS; between 10-15% of subscribers in New Jersey and 21% in the country choose DBS over cable.
- Four towns, Allamuchy, Montague, Sandyston and Toms River, have been found to satisfy the FCC's definition of "effective competition" upon a finding that DBS penetration is at least 15%. This effective competition declaration decreases the level of regulatory control the BPU may exert. These findings are paid for by the cable operators and have withstood challenges by the BPU. Consequently, more than three dozen New Jersey towns are awaiting possible findings of effective competition and the subsequent rate deregulation at the FCC.
- While cable and DBS have comparable programming, the existence of both in a town does not seem to produce downward pressure on rates.

### **Part II--Technical And Regulatory Barriers**

"The technical and regulatory issues associated with promoting multi-channel video programming competition in New Jersey by local exchange telecommunications companies and interexchange telecommunications carriers."

- There are no outright prohibitions or exclusions to telephone companies entering the video market; however, various state requirements may be viewed by some parties as impediments.
- While technical barriers to providing video over telephone lines are few, the expense of upgrading the existing infrastructure significantly impedes the offering of video services by local exchange carriers.
- Local exchange carriers like Verizon have strong incentives to provide video in order to replace the revenues they are losing to long-distance and wireless telephone companies.
- Verizon indicates it may deploy in the short-term a technology called Fiber to the Home ("FTTH"), which would allow for video, voice and data services. While the technology is expensive to deploy, it could be the ultimate solution for competition to incumbent cable operators if and when it emerges.

### **Part III--Internet as Telecommunications Service**

The technical and regulatory issues associated with classifying every high-speed Internet service as a "telecommunications service," as defined in section 2 of P.L.1991, c.428 (C.48:2-21.17).

- The rate regulation of high speed Internet services has mostly been preempted by federal regulations; the FCC continues to encourage a "hands-off" regulatory policy on these services in an effort to spur their development and deployment at greater levels.
- The classification of these services as telecommunications under current New Jersey law does not necessarily equate to providing the Board the ability to regulate their rates. Most likely, these services would be deemed "competitive services," and would not be subject to the traditional rate regulatory provisions now reserved for only a small number of protected services.

- Cable modem service was designated an interstate information service by the FCC in 2002; that decision, however, was vacated in October 2003 by the Ninth Circuit Court of Appeals in the *Brand X* decision.
- DSL service has been tentatively designated an information service with a telecommunications component by the FCC, although technical constraints continue to delay deployment of DSL service by incumbent local exchange carriers (“ILECs”), and competitive issues restrain the ability of competitive local exchange carriers (“CLECs”) to offer the service on as wide a scale as seen with the deployment of cable modems.

#### **Part IV--Non-Discriminatory Access**

“A requirement that a cable television company shall provide its competitors non-discriminatory access to the CATV company's cable communications system.”

- Issues in this area arise in two contexts: (1) Access for multi-channel video programming service providers, which could be characterized as non-facilities based marketers or packagers of programming, and Internet service to the cable operator’s lines in competition with its own product offerings; and (2) Programmer access to the service packages sold by the franchised cable operator to its customers.

##### Multi-channel Video Provider Access

State requirement to provide access would be problematic for a number of reasons, some of which parallel the arguments for and against access for Internet Service Providers discussed elsewhere in this Report.

- State and local authority over cable is limited to specific matters and actions expressly delegated in the federal Communications Act, as amended in 1984, 1992 and 1996.
- Open access as applied in the telecommunications industry is a poor model for cable. Antecedents in statute, business models, and nature of the product are very different than those in telecommunications.
- Broadcast or satellite signals are not as readily distinguishable or separable into interstate or intrastate, as has been the historical case of point to point telephone calls.

##### Programmer Access

There are three types of access primarily available over cable systems, which enable non-affiliated programmers access to channel space in the cable systems service packages.

- *Leased access* laws require channel capacity to be made available to programmers to purchase time and/or channels. It includes an FCC-administered process for protecting the rights established for programmers and for insuring the programmers are charged fair rates. The dominant program content under this framework is infomercials.
- *Non-Operator Affiliated Access* is designed to keep cable operators from favoring affiliated programming services or channels delivered over satellite. This has been an issue in New Jersey with respect to regional sports programming. The premier example of this conflict

was the battle between Cablevision and the YES Network, which carries regional sports programming (Yankees and Nets) in competition to regional sports teams and programming affiliated with Cablevision. The matter was settled through arbitration, but the agreement expires this year.

- *Public, Educational, And Governmental Access Channels* are determined on the municipal level through the franchise process in New Jersey. There are no statewide requirements, and the local arrangements vary widely. Occasional disputes concerning these channels are handled by the Office of Cable Television on a case by case basis.

## **PART ONE: THE STATE OF COMPETITION**

**“The state of multi-channel video programming competition between different facilities-based and non-facilities-based telecommunications companies in New Jersey, such as cable television companies, digital broadcast satellite companies, local exchange telecommunications companies and interexchange telecommunications carriers and, in particular, the state of competition in New Jersey among the dominant cable television companies for the same customers”**

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## **PART ONE: THE STATE OF COMPETITION**

The vast majority of competition in multi-channel video programming competition nationally occurs between CATV companies who represent about 75% of the market and DBS companies that represent about 15.4% of the market.<sup>9</sup> Satellite Master Antenna (“SMATV”), which claims 1.8% of the national market, or 1.5 million subscribers, uses the same technology as cable but does not cross the public rights-of-way. OVS represent less than 1% of the national market. These technologies – as well as Internet Video and Video on Demand – are discussed below.

### **Cable Television: An Overview**

Seven cable television operators franchised by the BPU provide services to about 2.5 million residents, covering all but two of the state’s 566 municipalities. Consolidation and clustering of systems by Comcast and Cablevision has left most systems in the state with contiguous service territories.

Comcast presently ranks as the largest cable television operator in both New Jersey and the nation. It provides service to 1.4 million households, or 55% of the State’s cable television customers. Areas served range from Jersey City and parts of Essex County, some central areas, including Trenton, and throughout the entire southern half of the State. The system is fully upgraded and now offers digital and Internet service in all parts of its service territory.

Cablevision serves about 950,000 homes (37% of all the state’s cable homes) in large parts of the northern and central regions of the State. With its completion of rebuilds and upgrades last year, digital and Internet service is now available to all Cablevision customers who want it. Internet based phone service over the system has been offered in its Tri-state systems since late last year.

Patriot serves about 80,000 customers in the central part of New Jersey. It is a company formed by a long-time cable entrepreneur specifically to acquire the two systems in New Jersey formerly operated by RCN Corporation, in 2003.<sup>10</sup> Since taking over these systems, Patriot has been completing the rebuilding and upgrading of the plant and service offerings, including two way high speed Internet service.

Despite being the nation’s second largest cable television operator, Time Warner has only 60,000 New Jersey customers, with all of its franchises located in Bergen County and the Town of Guttenberg in Hudson County. Through its state of the art system, Time Warner offers a full range of TV programming, digital and Internet services.

Service Electric Cable TV, one of the oldest cable companies in the country, covers Sussex County and parts of Warren, Morris, and Hunterdon counties. Rates for its 53,000 homes in those communities are not regulated due to its classification under Federal law as a small system operator. Internet service is not available until completion of planned upgrades in the system.

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<sup>9</sup> The FCC notes in its Tenth Annual Report that ten years ago cable served approximately 100% of all the nation’s MVPD subscribers, but in 2004 cable’s share had fallen to approximately 75%. This decrease, among other factors, led the FCC to conclude that “competition” exists in the industry due to the decrease in cable’s dominance.

<sup>10</sup> RCN Corp. is currently in negotiations to restructure its debt and will likely announce a corporate reorganization through Chapter 11 bankruptcy. See [www.rcntomorrow.com](http://www.rcntomorrow.com) for current information.

U.S. Cable serves 5,600 customers in Hillsdale and Paramus, in direct competition with Cablevision. U.S. Cable's corporate parent is based in Montvale, New Jersey. U.S. Cable, which had previously sold its systems in New Jersey, re-entered the New Jersey market in 1999, when it purchased the Hillsdale-Paramus system from Cablevision, which had to divest the system under the FTC's order approving Cablevision's acquisition of a large number of TCI systems around the country. As a small system, none of U.S. Cable's rates can be regulated.

Hometown Online, a cable television subsidiary of WVT (formerly Warwick Valley Telephone) received certification by the Board in 2002 to provide cable TV service in Vernon (Cablevision) and West Milford (Service Electric) townships, each of which was already served by franchised operators. The parent company has provided telephone service as an incumbent local exchange carrier since 1903. This system utilizes VDSL technology over its telephone plant to offer a bundled package of TV, Internet and telephone services. As of January 1, 2004, Hometown Online had 777 customers for a penetration rate of 16%. As both a small system and one found subject to effective competition by the FCC, Hometown's cable television rates are unregulated.

### **Cable Competition in New Jersey**

A handful of laws and regulations have had the greatest impact on cable competition in New Jersey: the Federal Cable Act,<sup>11</sup> the 1972 State Cable Act,<sup>12</sup> the 1992 Cable Television Competition and Consumer Protection Act, the 1996 Act and the current FCC's "Effective Competition" rules.

Of these, the FCC's "effective competition" rules have the greatest impact on New Jersey consumers. The "effective competition" rules set by the FCC govern whether or not DBS is deemed a competitor to the cable business. There are four criteria that govern whether or not the "effective competition" standards apply. Of the four criterion only one seems relevant today in New Jersey: the "50-15" test. The "50-15" test means 50% availability and 15% penetration of comparable technology and services in the same geographic area.

Once the "effective competition" threshold is reached, the cable companies in those areas are exempt from rate regulation. Therefore, this is the most important factor in determining whether DBS is deemed a competitor to cable for the purposes of rate regulation of cable companies. The FCC has already declared four New Jersey towns subject to Effective Competition (Allamuchy, Sandystone, Montague and Toms River, Verizon's sole entry into the video market nine years ago) and thus all cable rates, including the basic tier and equipment rates charged there, are unregulated. It is under this test that scores of New Jersey municipalities face deregulation. Currently more than three dozen petitions await the FCC's effective competition determination.<sup>13</sup> Therefore, the success

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<sup>11</sup> A franchise is required by the Federal Cable Act in order for a company to supply cable television service. 47 U.S.C.A. § 541. The franchising process for cable television operators in the State is governed by both federal and State law and regulation.

<sup>12</sup> Under N.J.S.A. 48:5A-1 *et seq.*, cable television franchises are non-exclusive. The federal 1992 Cable Television Competition and Consumer Protection Act prohibited the awarding of exclusive franchises by local franchising authorities. In addition, the Telecommunications Act of 1996 allowed telephone and electric companies to enter the subscription TV market. Finally, the Effective Competition rules which indicates when basic cable rates are deregulated for certain municipalities, which are not otherwise deregulated, determines when markets are "competitive" at the local level.

<sup>13</sup> Towns include: Avon-by-the-Sea, Brielle, Bogota, Closter, Colts Neck, Creskill, Englishtown, Franklin Lakes, Garfield, Freehold, Haledon, Howell, Interlaken, Kinnelon, Manalapan, Manasquan, Marlboro, Millstone, Neptune, Ocean, North Caldwell, Old Tappan, River Vale, Rochelle Park, Rockleigh, Prospect Park, Saddle River, Sea Girt, South Hackensack, South Orange, Upper Freehold, Upper Saddle River, Wall, West Paterson, Wood-Ridge, Woodcliff Lake, Jackson, Washington, Old Bridge, Sayreville, Aberdeen, Manville, Bound Brook, Green Brook, Raritan, South Bound Brook, Warren, Spring Lake and Union Beach.

of DBS under the FCC rules plays a huge role in how cable competition is perceived and the application of the definition may create a “gap” between consumer expectation and market reality.

The FCC, in its Tenth Annual Report on Competition issued in January of 2004, states that competition often results in added channel offerings for the same monthly rate, improved services or additional non-video services. Federal regulators and consumers, however, have different definitions of competition. To some consumers, “competition” may mean companies that compete head-to-head in the same geographic area for the same customers in the same categories of service. To others, “competition” simply means the greatest range of programming and Internet services available for the highest quality at the lowest prices. In either case, the BPU has challenged the premature debut of deregulation as early as 1995 and formally challenged “Effective Competition” rules in a legal brief in 2002. The FCC’s operative definition of “effective competition” is a service area in which multi-channel video programming available to at least half the households in a franchise come from at least two unaffiliated providers offering comparable video programming.

The BPU previously challenged the FCC’s exclusive reliance on Sky Trends – now the function of SBCA (successor to Sky Trends) – as the basis for measuring and deregulating local markets. Neither the data nor the method by which they count households can be validated. The FCC Bureau Chief stated, in March 2004, that any major policy shifts at the agency in defining effective competition was unlikely. Therefore SBCA will continue to be relied upon for DBS penetration without independent third party verification because the FCC says it is unable, with its current resources, to challenge these unaudited measurements.

Furthermore, as this Report will show, the effective competition rules do not necessarily stabilize cable prices. In addition, the apparent absence of “head-to-head” competition in New Jersey tends to undermine consumer confidence, where consumers assume head-to-head competition is necessary to produce the lowest prices among their cable providers. A General Accounting Office (“GAO”) study found that where cable operators faced competition from overbuilders, the overbuilder’s prices tend to be lower than the incumbent’s. In New Jersey, a customer typically has only the choice of one cable provider or one DBS provider in the customer’s geographic area. This contributes to why some consumers feel they have little “choice” when it comes to selecting a service provider. Further, the lack of government control of two-thirds of the competitive tiers and programming services prices fuels the dissatisfaction.

Both the Ratepayer Advocate and the League of Municipalities (the “League”) have questioned whether “competition” exists in New Jersey, especially under the standards used by the FCC. The League states:

Here in New Jersey, there is no effective competition in the CATV market. Although such competition is permitted, as a practical matter it does not occur. Choosing satellite or over-the-air broadcasts are alternatives; however, they do not offer competition.<sup>14</sup>

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<sup>14</sup>Statement of Albert Licata, Bernards Township Deputy Mayor; Chair, League of Municipalities Telecommunications Task Force, Public Hearing, In the Matter of the Status of Broadband Telecommunications and Multi-Channel Video programming Competition in New Jersey (February 26, 2004).

Based on the results of our February 26, 2004 public hearing, it seems apparent that these rules do not promote competition as either consumers or providers expected. As such, the federal "Effective Competition" rules need to be re-evaluated by the FCC to determine their impact on local markets.

There are seven municipalities in the state where "competition" exists: two from competing traditional cable operators and four from competing industries. In Bergen County, Paramus and Hillsdale have, from the late 1970s, had two cable operators franchised to serve both municipalities. In Sussex and Passaic Counties, Hometown On Line, an affiliate of a small ILEC, WVT Communications, provides competition to incumbent cable operators SECTV and Cablevision in the towns of Vernon and West Milford respectively. Lastly, in Passaic County and Warren County, Cablevision provides unregulated service in the towns of Montague, Sandystone and Allumuchy. These towns in 2002 were deemed subject to effective competition and therefore removed from rate regulation upon the FCC's acceptance of DBS penetration figures in excess of the 15% threshold.

The Office of Cable Television has expedited wireline competitors' applications to "overbuild" incumbents in our State and opposed applications from cable operators who wish to declare competition from DBS companies because, as discussed below, the cable industry's exclusive access to the measurement tool for DBS penetration, Sky Trends, puts regulators and subscribers at a disadvantage.

#### Factors that Affect Competition

A number of technical factors affect the success or failure of cable competition in New Jersey, including the need for capital-intensive wiring. Due to the need to invest in a duplicate infrastructure, which is expensive, not every potential competitor can enter, let alone sustain competition in the cable market. The historic challenges, both financial and technical, as noted by the FCC, as well as New Jersey's own previous experience with overbuilders, attests to the impracticability of certain overbuild models. In the early 1990s, Shore Cable, after a few short years of limited service in the Atlantic City area as an overbuilder, sold its system to the rival cable operator. Bell Atlantic exited the Video Dialtone competitive model in Dover Township (Toms River) in the late '90s after engaging in a price war with the incumbent Adelphia for two years.

Cable operators are subject to more regulatory oversight than DBS competitors but there is little room for state action with regard to pricing by DBS companies. Some states have considered legislation to tax these providers. The cable companies would invite that action of leveling the playing field since the cable industry is subject to franchise fees as well as other state taxes.

Consumers consider a number of factors when selecting among cable providers or alternative services, such as DBS. The number of channels available, system reliability, and video quality, especially in rebuilt systems, all cause consumers to favor the cable operator over other alternatives in many instances. In addition, cable's ability to deliver telephone and high speed internet services, as well as its PEG access channels at a local and regional level and the ability to engage in simultaneous viewing and recording also make cable the most popular choice among consumers. While the NJCTA estimates overall penetration of DBS in the State is between 10-12%, it also argues in some areas it can exceed 20%. Further, if Verizon begins offering DirectTV packaged with its own telecommunication services, it could boost penetration higher.

Pricing is one of the major components that affect the ability of providers to compete for customers. Cable's ability to bundle services make this business model well positioned to compete with other providers for the same services such as local exchange carriers. According to the FCC's Tenth Annual Report, the cable industry invested more than \$75 billion to upgrade its cable plant,

resulting in the introduction of non-video services such as Internet access and telephony.<sup>15</sup> While it is unknown how much the industry has actually invested in the State in this regard, arguably cable operators' investment has spurred further development and new business initiatives by rival providers, as evidenced by the alliance of Verizon and DirectTV. In addition, cable offers an increasing range of services and added customer service support, some of which are now legislatively required. Although cable companies state that these requirements increase costs, it can also be argued that this higher level of service may help to solidify a customer base estimated to be between 69% and 84% in the State.

Notwithstanding the increase in competitive services as defined by the FCC, cable rates on unregulated tiers have also risen. In New Jersey, cable programming service tier rates have risen 12% between 2002 and 2003. During the same time period, cable prices rose 5.1% overall compared to a 2.1% increase in the overall CPI. The price differences between cable and DBS will be detailed below. Even with the growing discontent with cable price increases, it may not be profitable for an alternate provider to compete in this manner as discussed in the cable rates section, which may explain why cable companies do not overbuild and compete head-to-head. The economics of construction and operation present "considerable challenges" including raising funds to replicate the capital-intensive networks already established by the cable operator.<sup>16</sup>

In addition to traditional cable, one such alternate provider is broadband service providers ("BSPs") who compete with existing cable systems using state of the art systems that bundle telecommunications services including voice, video, and high speed Internet access.<sup>17</sup> According to the NJCTA, New Jersey has the fifth highest number of broadband subscribers, nearly one million, and the high-speed lines include five DSL providers, five providers of high-speed cable, and 13 satellite and fixed wireless system providers. These satellite and fixed wireless system providers serve almost 1.4 million subscribers nationally, and include providers such as RCN, the largest (460,000 subscribers), followed by WideOpenWest (290,000 subscribers) and Knology (130,000 subscribers).<sup>18</sup> Still, while this broadband business model is not able to compete with cable for all of its service offerings, companies that do not provide the "triple play" of voice, video and data are now partnering with companies that can provide services they do not and forming marketing and business alliances to provide these services.

According to some critics, foreign deregulating of telephone companies, and the associated decrease in the regulatory structure, has had a huge impact on the development of broadband as a competitor to cable. According to one statistic, 73% of South Korean households subscribe to high speed Internet, whereas only 18% of U.S. households subscribe to a broadband service, despite the service being available to 89% of U.S. households.<sup>19</sup> The NJCTA submits that 23% of the State's population subscribe to one of the 17 broadband service providers in the State, while such services are available to 95% of the State's residents. In foreign countries such as Korea and Japan, with deregulated phone systems, and with dense urban populations, faster forms of DSL and some limited forms of fiber-to-homes options have been available. Therefore, in a real sense, "competition" deals directly with the question of national policy and regulation, which will be

<sup>15</sup> *FCC Tenth Annual Report on Video Competition*, at p. 8.

<sup>16</sup> *In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, MB Docket No. 03-172, 18 FCC Rcd. 16,042, released July 30, 2003 (hereinafter, "*FCC Ninth Annual Report on Video Competition*").

<sup>17</sup> *Ibid.*

<sup>18</sup> *FCC Tenth Annual Report on Video Competition*. It should be noted that Knology filed for Chapter 11 bankruptcy protection in September, 2002 and WideOpenWest filed for Chapter 11 bankruptcy protection in February, 2004.

<sup>19</sup> "Broadband: What's the Hold-Up?" *Businessweek*, March 1, 2004, pp 38-39.

discussed in Part II of the Report.

### **Direct Broadcast Satellite**

DBS services were introduced in 1993, and presently have 21.63%<sup>20</sup> of the nation's multi-channel video programming service customers. Among the reasons DBS is considered competitive to cable is its growth rate. According to the FCC, since DBS's introduction, the DBS growth rate has exceeded the growth rate of cable by double digits in every year except the past year, when DBS growth exceeded cable growth by 9.16%. The total number of DBS households grew 11% between June 2002 and June 2003, with 2.2 million additional households subscribed to DBS.<sup>21</sup>

Direct TV ranks second next to Comcast in total video programming customers nationally. During the past two years, there have been a number of attempts by media companies, including Cablevision, to acquire a DBS company. A merger attempt between EchoStar and DirecTV came apart under federal regulatory and Congressional opposition in 2002. Approximately 12% of subscribers to a multi-channel provider in New Jersey select a DBS company.<sup>22</sup>

Hughes (doing business as DirecTV) had 11.6 million customers by mid 2003, making it the second largest multi-channel programming provider in the country. After the EchoStar merger failed, the FCC conditionally approved acquisition of a 34% interest in Hughes by News Corp., owner of the Fox Entertainment Group.

EchoStar (doing business as the DISH Network), which also serves the New Jersey market, has 8.8 million customers nationwide, and ranks as the fourth largest multi-channel video programming provider.

Rainbow DBS (doing business as Voom) which was introduced in October, 2003, is an affiliate of Cablevision and uses a new spot beam technology which the company expects to allow delivery of more localized programming and broadcast channels. No customer data was available during the drafting of this report.

### DBS Competition in New Jersey

There is little federal oversight of DBS providers and states are pre-empted from any rate regulation that affects DBS. While the 12-15% market penetration in New Jersey is below the national average of 21%, DBS remains the most prominent delivery service outside of cable. As discussed above, the FCC effective competition rules have a pronounced effect on the cable industry, the main competitor to DBS. The "effective competition" rules set by the FCC govern whether or not DBS is deemed a competitor to the cable business, and whether or not "competition" exists between cable and DBS providers.

The DBS industry has been unwilling to provide information on penetration. The best estimates are based on data from SBCA. Without this information, and where no true competitors are offering the same service, in the same market, by the same delivery model, consumers may not perceive "choice" between video providers. Therefore, the "choice" in New Jersey may be somewhat illusory to the consumer. These differences in assumptions and beliefs not only explain the "gap" between consumer expectations and attainable market choices, but also explains why the FCC's regulation of this market has been deemed a failure by many of its critics.

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<sup>20</sup> *FCC Tenth Annual Report on Video Competition*, ¶ 8.

<sup>21</sup> *Ibid.*, ¶16.

<sup>22</sup> Written comments of NJCTA, p.4, n.6.

### Factors affecting DBS competition

The absence of local franchising fees, PEG access commitments and service obligations are examples of the competitive regulatory advantages DBS enjoys over cable. One common complaint of the cable industry is that they are competing with DBS on an “unlevel playing field” because DBS is not regulated.

Some of the key distinguishing features of DBS that make it attractive for consumers are its number of channels – ranging above 500 – and its audio and video quality based on its digital capability. In addition, interactive and video on demand services have proven to attract customers. As technology improves, the dish size which receives the service also decreases, making the technology less cumbersome and more adaptable. Finally, DBS service offers a plethora of regional sports packages, though it also can involve more expensive up front costs. In most markets, the service packages offer comparable or lower program rates than cable with ongoing promotional campaigns.

The down-side, from a consumer perspective, includes the up front costs which can be more expensive, and contracts which tend to be long term. The service can also be subject to signal fade in certain weather, as well as digital artifacts and “noise.” Also, because there is no state regulation of DBS, there is little inherent consumer protection, and the BPU does not monitor complaints about service problems or enforce customer service requirements.

A comparison of rates between Cable and DBS follows at the conclusion of this section.

### **SMATV**

SMATV systems, also known as “private cable,” often serve hotels and motels, apartment buildings, hospitals and private residential communities. They do not use the public rights-of-way<sup>23</sup> and therefore are neither subject to franchises or other requirements of the State Cable Act, nor fall within the BPU’s jurisdiction. Since they are not registered with the State, records are scarce. This industry has a 1.8% share of the national market.

Although no precise data on the number of complexes in New Jersey has been provided, the potential market for these private systems encompasses about 500,000 units in mobile home parks and in complexes with ten or more units. The NJCTA provides 2000 census figures that state 35.1% of housing units in the state are multi-unit structures.<sup>24</sup>

### SMATV Competition in New Jersey

There are an unknown number of unfranchised “private” cable systems in New Jersey and throughout the country operating outside of the jurisdiction of the BPU or individual municipalities, and they are not required to register with the OCTV. It is only through customer complaints that these systems are identified to the OCTV, at which time a technical investigation is initiated to ensure the system should not be regulated as a cable system under State and federal law.

There have been a number of uncontested conversions of SMATVs over the course of the years, and often the private cable systems are purchased by the incumbent operator and certified as part of the approval process for asset purchases under the State Cable Act. Currently, there is one

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<sup>23</sup> 47 U.S.C.A. § 522(7).

<sup>24</sup> Written comments of NJCTA, p.5.

contested certification, where, pursuant to the Board's regulatory jurisdiction over cable television systems, the BPU found that RCN Telecom Services, Inc., in serving the residential multi-dwelling units known as the Newport complex in Jersey City, was using the public right-of-way such that its SMATV system was operating as a cable system subject to BPU regulation. The ruling by the Board that RCN must obtain a cable television franchise pursuant to N.J.S.A. 48:5A-1 et seq. is being challenged in the Superior Court, Appellate Division in Docket No. A-6422-02T3.

#### Factors Affecting SMATV competition

This service may offer long-distance and Internet access, with a varying number of channels. There is less regulation in this area than cable and no regulatory fees. This service is offered to a limited subscriber base consisting almost exclusively of multi-dwelling units. It also offers no local PEG access channels, but has lower prices. These services vary widely in the sophistication of the services offered, and many fall short of the systems offered by cable providers. For example, Covered Bridge in Manalapan is served by a Master Antenna service operated by Cablevision which provides only 12 channels.

#### **Open Video Systems**

This technology involves a facility consisting of a set of transmission paths and associated signal reception and control equipment that is designed to provide cable service to multiple subscribers within a community. An OVS operator must open its "platform" to other programmers. Part II of the Report provides a more detailed description of OVS.

#### **Other Technologies**

##### Wireless Television

The term "wireless" is an umbrella name for several types of technology involving microwave TV signals emitted from transmission tower used to provide microwave based TV signals to a relatively local area, extending approximately 30 miles from a given transmission tower. Subscribers to wireless television comprise approximately 3% of the national market.

Originally, this technology was used as part of the Instructional Television Fixed Service ("ITFS"), which was created for educational purposes such as the local transmission of college courses to students unable to attend classes at a centralized location for various reasons. The technologies employed in wireless TV include MMDS or conventional wireless, and Local Multipoint Distribution Service ("LMDS"), a new type of service offering with a shorter range, which employs cellular transmission technologies. With just under a million subscribers signed up since the first MMDS system became operational in the 1970s, wireless has generally not been received well by the public, due to both real and perceived limitations. Systems are, however, able to achieve profitability with lower market shares due to lower start up and capital costs. Recent trends suggest that this technology is upgrading its network to offer two-way communications (i.e. Internet).<sup>25</sup>

##### Internet Television

Internet Video allows for access to the Internet over a television using a set-top box and Web TV or Worldgate Service Packages, resulting in a convergence of the traditional home television set and computer. Web TV uses a wireline Internet connection via a phone line to a

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<sup>25</sup> *FCC Ninth Annual Report on Video Competition.*

computer like box and keyboard, with the TV set as a monitor. With the migration to flat screen, LCD or plasma televisions and computer monitors, the two devices will likely evolve into one within the next few years. At present, video pictures offered over the Internet are less than broadcast quality and the medium is not truly a direct competitor to providers of traditional television video services.

#### Video On Demand

A common complaint to the Office of Cable Television from customers is that they are forced to buy programming channels in packages, and must pay for channels they do not necessarily want. Video on Demand offers a solution.

Customers now want what they want, when they want it. Comcast cited “changed customer tastes” as the basis for its Philadelphia trial of its “video on demand” services. Half the cable subscribers whom participated in the trial used the “video on demand service” and viewed an average of 13 movies per month. Digital recorder boxes are now being introduced which add a VCR like recording function to the increasingly sophisticated cable TV box. This service requires the cable operator to establish licensing arrangements with the broadcast channel or programming provider, so it is not yet available for all channels.

#### Direct Video Downloads

While as noted above, the quality of video motion pictures offered over the Internet is not broadcast quality, it is improving as Internet capacity and speeds improve. A new business model is now emerging in the audio music industry as a result of the success of ventures such as Apple Computer’s iTunes music distribution system, wherein individual songs and entire albums are sold directly to the individual customer over the Internet. This will profoundly affect the current packaging and distribution of television programming, much in the way recording retailing and distribution of music is being affected by the Internet. In this sense, the market is responding to customers demands for choice, and if the recording industry holds as a model, price as well. How quickly this development expands to video and voice services depends on the speed and capacity of the Internet and cable operators and telecommunications provider networks.

#### Electric and Gas BSPs

While the New Jersey video market cannot claim any entry by electric and gas utilities into the video programming market, a few scattered systems across the country include Potomac Electric and Power Company (PEPCO) in Washington D.C. that offers voice, video and data services as “Starpower,” a joint venture between the utility and RCN. PEPCO announced it was seeking to sell its interest in the project the same day RCN announced it would file for Chapter 11 re-organization bankruptcy protection. These projects do not make use of electric power lines for distribution but do make use of their rights of way through poles and conduits.

The FCC’s 10<sup>th</sup> Annual Report on the Status of Competition in the Market for Video Programming state that electric BSPs continue to provide competition in “scattered localities” and often in rural areas where cable operators may not provide advanced telecommunications services. Municipalities, in some cases, provide broadband services to their own residents in mostly unserved areas. Kutztown, Pennsylvania, for example, built a fiber loop in 1999 hoping that the private sector would step in and provide voice, video and data service but was forced to offer the services themselves when no one from the private sector appeared. Similarly, in locations like Cedar Falls, Iowa, the municipality has built a broadband access network offering voice, video and data services.

The FCC report also states that the American Public Power Association (“APPA”) surveyed its members at the end of 2002, finding that 511 public power entities offer some kind of broadband services. Of those, 105 offered video services, 71 offered cable modem service and 37 offered local telephone service.<sup>26</sup>

Several electric utilities are also exploring the use of their existing power lines to provide broadband service. This new platform, Broadband over Power Line (“BPL”) has sparked significant interest around the country, and prompted the recent release of a Notice of Proposed Rulemaking (“NPRM”) by the FCC, which proposes changes to certain technical rules in an effort to foster broadband deployment using the significantly untapped capabilities of the nation’s power grid, while safeguarding existing electric service against harmful interference.<sup>27</sup>

### **Current Video Market Rate Structure**

#### Rate Structure Explanation: Video Service Providers v. Cable Service

As of February 29, 2004, the average monthly charge for basic cable service in the State was approximately \$12.67. In most cable systems, subscribers also must pay for equipment associated with the provision of basic service. If subscribers wish to expand the programming they receive, they can expect to pay, on average, an additional \$31.98 for an expanded basic tier. Moreover, premium channels can be added on an à la-carte basis, or in a package deal, for an additional charge, which would vary from system to system. Cable television subscribers are not required to purchase equipment in order to receive service, nor are subscribers required to enter into lengthy contracts for the provision of such service. Subscribers have the option each month to either continue their service or to cancel.

The most popular alternative to cable service available to New Jersey residents is DBS. Services such as DirecTV or Dish Network offer subscribers a vast selection of programming, up to 200 channels, received by way of satellite dishes installed at the subscriber's home. While the costs for these services vary from company to company, they tend to fall between \$24.99 and \$33.99 for a minimum programming package, without local channels, or \$29.99 and \$38.99 including local channels where available.

In order to receive certain discounts, DBS subscribers must enter into contracts, which bind them to that service for a designated number of months or years, and agree to early termination or liquidated damage payments for cancellation before the term. Subscribers to DBS must also pay a substantial amount of money for the purchase or rental of the satellite dish in addition to the amount for installation, although some installation charges are waived and certain other upfront equipment costs are credited to customer accounts in exchange for longer term subscription agreements.

In order to receive DBS service, customers must purchase or rent a satellite dish, a DBS receiver box, and depending on the type of satellite dish and number of receivers used, a switch. It is a recent practice to offer free equipment and installation as a marketing strategy for the service. Generally, there are three types of satellite dishes available, which vary according to their ability to

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<sup>26</sup> APPA Public Power: Powering the 21<sup>st</sup> Century with Community Broadband services (fact sheet) May 2003.

<sup>27</sup> Notice of Proposed Rulemaking, *In the Matter of Carrier Current Systems, including Broadband over Power Line Systems*, ET Docket No. 03-104; *Amendment of Part 15 regarding requirements and measurement guidelines for Access Broadband over Power Line Systems*, ET Docket No. 04-37, released February 23, 2004.

receive signals from single or multiple satellites and to connect to a single or multiple receiver boxes. The most basic packages now include a satellite dish that allows up to 4 receiver boxes to be connected. Since it requires only a single coaxial cable to connect between the dish and each receiver, it is relatively simple to install.

According to our on-line research, current promotions are available that offer professional installation free for basic DBS systems and include multiple sets, the first 3 (DirecTV) or 4 sets (Dish Network). Unlike DirecTV, however, Dish Network has also begun offering some promotions that do not require minimum subscription plans. Like cable television, the programming available for DBS services varies greatly, and each company offers different packages, ranging from 60 channels to 200 channels.

**COST COMPARISON OF CABLE TELEVISION  
AND ALTERNATE VIDEO PROVIDERS**

**DBS**

<u>SERVICE</u>	<u>BASIC PACKAGES</u>	<u>PRICE</u>	<u>EQUIP*</u>	<u>INSTALL**</u>
DirecTV***	115-195+Channels	\$33.99-\$87.99	\$99	\$0
Dish Network***	60-180+Channels	\$24.99-\$77.99	\$0	\$0

-versus-

**CABLE<sup>+</sup>**

Average Basic Service Tier Rate	\$12.67
Average Cable Service Tier Rate	\$31.98
Average Channel Capacity:	
Basic Service Tier	27
Cable Service Tier	44
Average Primary Installation Charge	\$44.21 <sup>++</sup>
Average Equipment Charge	

	<u>Non-Addressable</u>	<u>Addressable</u>	<u>Digital</u>
Converters	\$0.52	\$3.50	\$4.02
Residential			
	<u>HDTV</u>	<u>DVR</u>	
	Gateway <sup>+++</sup>		
	\$8.08	\$4.70	\$8.00
	<u>Standard</u>	<u>Digital</u>	
Remotes	\$0.21	\$0.20	

Notes:

\* DirecTV offers up to 3 receivers (converter) for a one-time cost of \$99, additional receivers may be added at a cost of \$49 each. The DirecTV agreement carries a \$150 early termination fee for early disconnection, and a \$150 liquidated damage fee for each receiver not activated within 30 days of installation. Dish Network does not charge for equipment, but some plans require the customer to pay upfront system costs between \$149 and \$199 that are refunded in 15 or 20 month credits of \$10 each. Other Dish Network plans without an upfront equipment payment require the customer to a \$5.00 per month rental fee per receiver (converter).

\*\* DirectTV offers free professional installation as part of its standard package for up to 3 sets; a fourth set can be added at the time of initial installation for a \$40 charge. Free installation requires purchase of annual programming contracts. Dish Network offers free professional installation as part of its standard package for up to 4 sets, but assesses a \$49 system activation charge that is credited back on the customer's first bill.

\*\*\* DirecTV and Dish Network offer additional a la carte offerings and packages for Movies, Sports, Adult programming and local broadcasts as well as pay-per-view movies and events. (Local broadcast packages range from \$5-\$6 per month for ABC, CBS, NBC, FOX and PBS, certain package pricing includes local channels at a slight discount).

+ Information as of February 29, 2004 and includes Unregulated Systems.

++ Cable companies regularly offer free or reduced priced service installations as part of new subscriber or subscriber service upgrade promotions.

+++ Applicable to VDSL Service. One Gateway device required for up to 3 sets.

### Facilities Based Competition

Until recently, there had only been three instances of head-to-head facilities based competition in New Jersey since the arrival of cable television in the Garden State. In the late 1970s, two cable television companies received municipal consent to build simultaneously in two towns—Paramus and Hillsdale. This dual build consists of co-located distribution systems, allowing each company to market to the other company's subscribers and persuade them to switch providers and choose their service. While this model offers a means of true competition, the results have not been indicative of real competition, to the extent that price wars have not occurred, and no major competitive marketing efforts were ever undertaken by either company. After Cablevision's acquisition of TCI's New Jersey systems, under a ruling by the Federal Trade Commission ("FTC"), Cablevision sold the TCI system in both towns to U.S. Cable. U.S. Cable now operates a stand-alone system covering the two towns.

In general, it does not appear that facilities based competition by two cable companies offering only video services has been profitable enough for either company to continue to compete in this manner for an extended period of time. The FCC reports that only 1.5% of all MVPD customers nationwide are overbuilder subscribers. It seemed therefore unlikely that direct competition between traditional franchised types of cable systems other than those established early on, like in Hillsdale and Paramus, would develop. Notwithstanding the unlikely expansion of cable wireline competition, it still appears that facilities based competition between a LEC and cable operator remains a significant possibility, and is in fact occurring today. Warwick Valley Telephone Company ("WVT"), through its operating subsidiary Hometown Online, Inc., offers head to head competition with the incumbent cable companies (Cablevision and Service Electric Cable TV

respectively in Passaic County and Vernon Township in Sussex County.) Using VDSL digital technology, WVT offers voice, video and data services over its existing twisted pair telephone network, providing 98 digital video channels. As noted above, Verizon, while not currently offering competitive video services in the State, has announced plans to begin testing a broadband alternative that would challenge traditional video systems which would extend fiber directly to the customer's home to offer speeds that are many times greater than what existing DSL and cable modems can deliver today.

Following is a comparison of rates in the only current competitive situations in our state:

<u>Cable v. Cable</u>						
<u>Company</u>	<u>BST Rate</u>	<u>CPS Rate</u>	<u>Monthly Charge</u>	<u>Install Charge</u>	<u>Converter Charge</u>	<u>Remote Charge</u>
<u>Cablevision/Oakland</u>						
Rebuild	\$11.30*	\$35.95	\$47.25	\$46.95	\$4.07	\$.27
<u>US Cable (Hillsdale and Paramus)</u>						
\$13.50	\$29.99	\$43.49	\$44.95	\$1.56/\$3.13	\$.31	

\*Includes \$1.42 system rebuild add-on

## **PART TWO: TECHNICAL AND REGULATORY BARRIERS**

**“The technical and regulatory issues associated with promoting multi-channel video programming competition in New Jersey by local exchange telecommunications companies and interexchange telecommunications carriers”**

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## **PART TWO: TECHNICAL AND REGULATORY BARRIERS**

There are virtually no regulatory barriers to telephone company entry in the multi-channel video market. The 1996 Act repealed restrictions on cross ownership and allowed traditional ILECs to provide video service. In the case of an OVS operator, as discussed below, the situation was a bit more complex because state requirements may apply.

While the regulatory restrictions associated with local exchange companies (“LECs”) and interexchange companies (“IXCs”) providing multi-channel video services are few, the technical side remains the primary impediment because of the limited bandwidth of existing telephone infrastructure. The technology exists to expand the bandwidth of legacy infrastructure, but the costs are prohibitive and therefore the business case for LEC provisioning of multi-channel video is poor. (The business case for IXCs providing video services is even worse considering they do not own a local distribution network.) The situation may be slowly changing, however, with the recent announcement that Verizon may soon deploy optical fiber technology to homes in states and jurisdictions where the regulatory environment is hospitable.<sup>28</sup> As discussed in more detail below, FTTH and other fiber-based services offer more capacity than any cable or satellite system now operating, allowing for the delivery of voice, high-speed Internet access and video services. Because of the substantial costs of such deployments, we are extremely reluctant to predict, in any short- and medium-term time frame, that Verizon will become a serious competitor in the multi-channel video industry via FTTH. Nevertheless, Verizon’s recent announcement that it will begin offering DirectTV this year bundled with local, long distance, Internet and wireless services may increase DBS subscribership

### **Regulatory Barriers**

The 1996 Act repealed the FCC’s limitations on telephone-cable cross-ownership, thus laying the foundation by which telecom companies could provide multi-channel video services in competition with cable providers. Moreover, consistent with the Congressional goals of promoting "flexible market entry, enhanced competition, streamlined regulation, diversity of programming choices, investment in infrastructure and technology and increased consumer choice,"<sup>29</sup> the Act provided for the creation of a new type of video platform known as OVS. OVS is a facility consisting of a set of transmission paths and associated signal reception and control equipment that is designed to provide cable service to multiple subscribers within a community.

OVS was established in the 1996 Act as a new framework for entry into the video-programming marketplace. As an enticement for LECs to enter into competition with cable operators, the provisions of the 1996 Act are designed to free OVS operators from many regulatory burdens imposed by prior law. Although OVS operators are subject to the same provisions as franchised cable television operators with regard to PEG access requirements, must-carry rules, ownership restrictions, and certain other regulations (see Part I supra), they may be free from all franchising obligations and regulations, rate regulations, consumer electronics equipment compatibility regulations, and consumer protection and customer service rules. Plus, if a LEC decides to go the traditional route and request franchise approvals, the BPU will expedite the process in order to insure that LECs can begin to provide competition with cable companies immediately.

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<sup>28</sup> Statement of Bruce Cohen, Esq., Vice President and General Counsel, Verizon-New Jersey, Public Hearing, In the Matter of the Status of Broadband Telecommunications and Multi-Channel Video Programming Competition in New Jersey, February 26, 2004

<sup>29</sup> Implementation of Section 302 of the Telecommunications Act of 1996, Report and Order and Notice of Proposed Rulemaking, CS Docket No. 96-46, FCC 96-99, ¶ 4.

While similar to a common carrier, the FCC chose not to regulate OVS as such in order to encourage common carriers to seek OVS certification and enter competition into the entertainment and information market. In return, an OVS operator must open its “platform” to other programmers. The OVS operator must offer two-thirds of the system’s total channel capacity to other video providers on a leased basis to enjoy the benefits of decreased regulation (in instances where demand for channel carriage exceeds system channel capacity of the OVS operator). Moreover, affiliated programming concerns can occupy no more than 1/3 of available capacity on the network. In contrast, traditional cable operators operate under no such restriction. Aside from the programming restriction and lesser federal regulatory burdens, there are little if any physical differences between OVS and a cable system.

There are 24 certified OVS providers in the country. RCN Telecom, a CLEC has received certification from the FCC to provide video services in its telephone service areas. It is currently operating in New York, Boston, and Washington D.C. In New Jersey, RCN Telecom obtained certification from the FCC in 83 municipalities and local authorization in thirteen municipalities (Jersey City, Hoboken, Bayonne, Edgewater, Fairview, Cliffside Park, Fort Lee, Weehawken and Guttenberg, Nutley, North Bergen, North Arlington and Lyndhurst). RCN estimated it would begin offering OVS at the end of 2000 but ceased all operations in the State by the end of 2003 after selling its cable systems to Patriot Media and abandoning its plant and plans to become an OVS operator in New Jersey. Analysts suggest that a flawed business model rather than State or federal regulatory issues contributed to the company’s financial woes and it now finds itself on the brink of Chapter 11 bankruptcy protection. The only RCN property remaining in New Jersey is a SMATV System in the Newport Center complex in Jersey City.

### **Technical Impediments**

While the regulatory impediments to multi-channel video provisioning by LECs have decreased substantially with the passage of the 1996 Act, the technical barriers have not. The PSTN still mostly consists of 100 year-old copper wires designed to allow two individuals to converse with one another, not for television transmission. In order for the PSTN to act as a cable platform, advanced broadband technologies must be deployed ubiquitously. Increasingly, new broadband technologies such as DSL allow users to access the Internet at speeds that are multiples of what the traditional dial-up modem would allow. Nevertheless, only 20% of U.S. households have broadband service, while the ratio is likely to increase to 44% during the next four years, according to the Yankee Group.

While broadband is a necessary antecedent to telephone-based video services, it alone is not sufficient to provide multi-channel video services. The reason lies in those 100 year-old copper wires that are optimized to carry only voice and have a bandwidth restricted to only 4 kHz. The worldwide PSTN can only transmit signals with this bandwidth suitable for speech. This limits the bit rate available over a telephone connection to a maximum of 56 kbps on a standard analog telephone, far below the 15 to 20 megabits per second (“Mbps”) needed to provide multi-channel video services. DSL is a technology created to allow a customer to receive broadband connections of between 500 kbps and 6 Mbps to the Internet or to other data networks over copper telephone lines that connect to their home and business in what is referred to as “the last mile.” DSL technology expands the frequency available over traditional copper telephone wires well beyond the 4 kHz used for voice, thus also increasing the data bit rate that can be transmitted over a telephone line. However, another DSL technology known as VDSL is seen by many as the next step in providing a complete home-communications/entertainment package. VDSL provides transmission speeds of up to 52 Mbps, sufficient to provide multi-channel video services. But VDSL's

performance comes at a price: It can only operate over the copper line for a short distance, about 4,000 feet.

The key impediment to widespread deployment of VDSL is the need for telephone companies to replace their main copper feeds with fiber-optic cable. Fiber optic systems use light impulses to transmit data over a glasslike filament, as opposed to transmitting electrical charges on copper wire or hybrid fiber coaxial cabling. The dilemma for LECs is that the wide deployment of VDSL can cannibalize existing and highly profitable high bandwidth business private line services. Moreover, because of the high retail cost of broadband service, the number of people willing to pay for broadband service and the revenue returned are currently insufficient for the LECs to make the business decision about extending and deploying broadband into new areas. Until broadband is widely deployed, moreover, the services, such as video, that create customer demand to use these high bandwidth services may not be available at a cost consumers are open to paying. The result is a cycle, where the carrier's failure to justify the spending of capital results in a lack of broadband applications and content, which keeps demand for the services relatively low.

The only example of a New Jersey company using VDSL is Hometown Online, a cable television subsidiary of WVT. The company received certification by the Board in 2002 to provide cable TV service in Vernon (Cablevision) and West Milford (Service Electric) townships, each of which was already served by franchised operators. The parent company has provided telephone service since 1903. This system utilizes VDSL technology over its telephone plant to offer a bundled package of video, Internet and telephone services. As of January 1, 2004, Hometown Online had 777 customers, and, as previously discussed, due to its size and federal regulation, is free of price controls.

While VDSL requires fiber deployment into the neighborhood, FTTH requires fiber directly to the customer's residence or business, and is seen by many as the ultimate solution for broadband access. Most of the telecommunications and cable networks within the United States, excluding the local loop from the central office to the end user's premise, already contain significant optical fiber. The task at hand nationally is to lay the same optical fiber in the last mile extending from a telephone central office or cable headend into the home or business. While there have been small-scale trials, FTTH is considered a longer-term strategy for broadband because of the expense of replacing the legacy copper wires.

## **PART THREE: HIGH SPEED INTERNET**

**The technical and regulatory issues associated with classifying every high-speed Internet service as a "telecommunications service," as defined in section 2 of P.L.1991, c.428 (C.48:2-21.17).**

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**PART THREE: INTERNET AS TELECOMMUNICATIONS SERVICE**

Cable modem, DSL and VOIP – all formats of high-speed Internet service – are undergoing vast regulatory changes. As a result, it would be risky to undertake any State regulation of these services at this time. The technical and regulatory issues are discussed immediately below, with a discussion of relevant cases under “FCC Rulings” and “Recent Court Challenges.”

**Impact In New Jersey**

As demonstrated below, the technical and regulatory issues associated with classifying every high speed Internet service as a “telecommunications service,” as defined within current New Jersey statutes, relies heavily on the ultimate classification of these services by the federal government. These rulings will ultimately determine the ability of the states to exercise jurisdiction, and the extent to which they will be permitted to regulate the service.

Although federal law provides for a greater regulatory role by the states for telecommunications services, a general reclassification of all high speed Internet services as telecommunications services does not necessarily equate to providing the state with the ability to regulate these broadband services in the same manner as traditional telecommunications services are regulated. Currently, New Jersey statutes do not provide for blanket regulation over each and every “telecommunications service” as defined by N.J.S.A. 48:2-21.17. In 1992, the Legislature revised the New Jersey statutes to limit traditional utility regulation to only certain “protected telephone services” which were not determined by the Board to be a competitive service. Concurrently, traditional long distance telecommunications services provided by interexchange carriers were deemed competitive services, and thus freed from traditional utility regulation.

**Rate Regulation In New Jersey**

Traditional rate regulation for certain local telecommunications services was modified by the Legislature in 1992 when the Board was empowered to approve plans for alternative forms of regulation submitted by local exchange carriers. Since 1992, Verizon –New Jersey’s rates have been regulated pursuant to a Plan for Alternate Regulation (“PAR”), while the majority of their services have been deemed competitive by the Board. Similar to the Legislature’s findings in 1992 that “[p]ermitting the competitive interexchange [long distance] telecommunications marketplace to operate without traditional utility regulation will produce a wider selection of services at competitive market based prices,” it is highly likely that the same would apply to high speed internet services, and they would be deemed competitive services under N.J.S.A. 48:2-21.17.

**Internet Services**

Currently, most users who access the Internet utilize dial-up modems that offer speeds of less than 56 kilobits per second. Increasingly, new broadband technologies such as cable modem and DSL allow users to access the Internet at speeds that are multiples of what the traditional dial-up modem would allow. This is what traditionally constitutes the definition of “high speed Internet access.” The FCC has defined “high speed” Internet access, in general, as a service that “enables consumers to communicate over the Internet at speeds that are many times faster than the speeds offered through dial-up telephone connections” and that enables subscribers to “send and view content with little or no transmission delay, utilize sophisticated ‘real-time’ applications, and take advantage of other high-bandwidth services.”<sup>30</sup>

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<sup>30</sup> *Proposed Rules, Appropriate Framework for Broadband Access to the Internet Over Wireline Facilities*, 67 FR 9232-01, 2002 WL 274748 (F.R.), CC Docket No. 02-33, CC Docket No. 95-20, CC Docket No. 98-10;

## Factors Affecting Cable Modem Competition

Cable modem service provides an attractive option for customers seeking alternatives to obtain high speed Internet access, as well as an additional source of cash flow for cable companies. Since cable modem service does not rely on the local telephone network, it does not face the technical constraints of provisioning as seen with DSL service (see Part II), and in some geographic areas, cable modem service provides the only vehicle for customers seeking broadband service. Cable companies also tout the fact that the cable modem service provides a continuous connection and is “always on,” therefore not requiring you to dial in each time a customer wants to access the Internet.

## Regulatory Status of Cable Modem

The regulatory status of cable modem service initially presented cable providers with lucrative opportunities. In March 2002, the FCC issued a declaratory ruling classifying cable modem service as an “interstate information service.” This classification effectively preempts rate regulation by local franchising authorities, and, in addition, relieves the cable operator from being assessed franchise fees on the gross revenues that the cable operator receives for the service. Concurrent with its ruling, the FCC initiated a rulemaking proceeding to determine the scope of the FCC’s jurisdiction to regulate cable modem service and whether cable modem service should be regulated under the law, in light of existing principles regarding regulation of the Internet and broadband services. A recent court ruling, *Brand X*, vacating the FCC’s classification of cable modem service as an interstate information service, has left this issue unresolved, and with the FCC focused on appealing the decision, all related rulemakings are on hold at this time.

### Cable Modem Rates

The classification of cable modem service as an interstate information service by the FCC precludes local franchising authorities such as the BPU from regulation of the rates. Thus, rates for cable modem service are currently free from regulation from both state and federal authorities.

Similar to the business plans of the telephony providers, cable providers typically offer bundled packages of cable television and cable modem services to its customers, with a reduced rate for the cable modem service for those that receive the package, as opposed to stand-alone cable modem service. Comcast High Speed Internet Service is \$57.95 per month for non-cable customers, while Comcast cable customers are charged \$19.99-29.99/ month for the first three months, and \$42.95 thereafter.<sup>31</sup> Customers that do not own a modem may purchase one for \$139.00 or lease one from Comcast for \$3.00/month. Cablevision offers its Optimum Online High Speed Internet Access service at \$49.95 to non-Cablevision cable customers, and to cable customers at \$44.95. Cablevision provides the modem free to customers for as long as they use the service, or customers can purchase one from Cablevision for \$65.00.<sup>32</sup>

### Cable Modem Customer Service

The subscriber must have a computer system and a working cable modem connected via an Ethernet or USB interface to establish cable modem services. As a result, the cable modem service provider may offer various installation service for a fee, which could include: the installation of

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FCC 02-42, February 28, 2002, n.2.

<sup>31</sup> [www.comcast.net](http://www.comcast.net)

<sup>32</sup> [www.optimumonline.com](http://www.optimumonline.com)

Ethernet device, modem and/or loading of service software in the subscriber's computer; any outside/inside wiring of the subscriber's premises that may be necessary; simple and complex customer service, and technical support. The cable modem service provider provides the billing, provision, and management of its accounts for its subscribers, as well as the sales and marketing of the service to solicit and obtain new customers.

### Consumer Protection Issues

There are presently no specific customer service provisions on the State or federal level regarding cable modem service providers. Customers can still avail themselves of the services of the state Consumer Protection agencies for instances where contractual disputes arise or fraudulent activities are alleged.

### **DSL**

DSL offers access to high-speed data networks or the Internet over a single pair of copper wires that connect to the home or business, but it is distance sensitive. Nevertheless, DSL is the most common alternative to cable modems. DSL claims more than 200,000 subscribers in New Jersey as reported by DeHavilland Information Services, compared to the 700,000 cable-modem users in New Jersey.<sup>33</sup>

There are over 30 providers of DSL service in New Jersey including Earthlink, Galaxy DSL, Juno Express, Telocity, Net Access and FASTNET, to name a few. Although these services are not in direct head-to-head competition with cable or DBS, the phone companies' ability to provide these services may ultimately affect its ability to compete with cable and DBS in multi-channel video programming or other areas over the long run.

### Factors Affecting DSL Competition

Some would argue that high speed Internet offerings by cable companies were the impetus for the ILEC's aggressive deployment of DSL in recent years. Cable modem subscribers have far outnumbered DSL providers in the last three years, with DSL making slow and steady increases to attempt to catch up to cable. The technical limitations of DSL deployment place limits on the service areas where DSL is available. One of the primary problems, known as the "distance limitation," limits DSL to only those locations within a three mile maximum loop from the ILEC's central office. This allows cable modem service to stand as the only broadband service available in certain areas.

In addition, the FCC's rulings requiring DSL be made available to competitors under the unbundling requirements of the 1996 Act have spawned numerous CLEC DSL providers. The ability of CLECs to require ILECs to unbundled necessary equipment may be curtailed by ongoing FCC proceedings, such as the Triennial UNE Review, and the fact that several FCC rulings on this issue have been vacated and remanded to the FCC following decisions on appeals.

### DSL Rates

DSL is classified as an interstate telecommunications service by the FCC, and, therefore,

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<sup>33</sup> VDSL, with speeds that surpass both DSL and Cable Modem, can overcome distance limitations through a fiber optic gateway and requires one line connection that can support phone as well as data traffic. Currently, Warwick Valley Telephone offers VDSL to 777 customers in New Jersey. Other homes and business in New Jersey are connected to the Internet by satellite or wireless providers.

rates for DSL service are not regulated by the Board. The pricing for most ILEC DSL offerings are similar to those offered by the cable providers for their high speed Internet service. Verizon's residential DSL service is available at \$34.95/month, with customers choosing a bundled packaged of Verizon local and long distance service receiving the DSL service at a discounted rate of \$29.95/month.

#### DSL Customer Service

Although the Board may monitor DSL complaints, currently there are no requirements on the state level for the Board to address DSL customer service issues. The BPU, however, does attempt to informally resolve concerns between consumers and DSL providers, when appropriate.

#### **Voice over Internet Protocol**

VoIP, introduced over eight years ago, is a category of hardware and software that enables people to use the Internet as the transmission medium for telephone calls. For users who have free, or fixed-price Internet access, Internet telephony software essentially provides free telephone calls anywhere in the world. To date, however, Internet telephony does not offer the same quality of telephone service as direct telephone connections.

#### How VoIP Works

VoIP is the sending of voice information in digital packets rather than the traditional circuit-committed protocols of the PSTN. A major advantage of utilizing this protocol is the avoidance of access charges required when using the PSTN, as well as regulatory filings.

#### Factors Affecting VoIP Competition

Currently, there exists no uniform model for the regulation of VoIP. On February 12, 2004, the FCC issued a Notice of Proposed Rulemaking to address the issue of regulation, public safety, E911, law enforcement access, consumer protections and disability access. In connection with this proceeding, the FCC initiated a Communications Assistance for Law Enforcement rulemaking proceeding to address the technical issues associated with law-enforcement access to Internet-enabled services.

#### **The following are examples of the positions of other parties to this issue:**

- FCC Chairman Michael K. Powell has stated "No regulator, either federal or state, should tread into this area without an absolutely compelling justification for doing so."
- California Public Utility (CPU) Commissioner Carl Wood argued that regulators have an obligation to oversee telephone services, whether they travel over traditional lines or the Internet. Further, "The advent of Internet phone calls does not in and of itself exempt it from telecommunications regulation."
- However, CPU Commissioner Susan Kennedy, named by the FCC to its national commission on advanced telecommunications services, is in the forefront of the CPU's new "wait and see" stance on VoIP. According to press reports, Kennedy has said the CPU will wait until the FCC makes up its mind on whether or not to regulate VoIP.
- The US District Court in Minnesota imposed a permanent injunction against the Minnesota

Public Utilities Commission from requiring Vonage, a New Jersey based corporation, to obtain state certification as a telephone company.

- The National Association of Regulatory Utility Commissioners issued a resolution that resolved that phone-to-phone calls over IP networks are telecommunications services and should be regulated as such.
- Florida has taken a “hands-off” approach to VoIP. New legislation mandates that VoIP be free of “unnecessary regulation... regardless of the provider.”
- The New York PSC in 2002 issued a decision in a complaint proceeding between two carriers, finding that a provider of intrastate long distance services using IP telephony is subject to access charges because it is providing a telecommunications service, not an information service. The PSC noted that this issue was part of a specific complaint and did not constitute a general policy ruling.
- In response to a filing by Qwest, the Colorado District Court for the City and County of Denver concluded in 2001 that VoIP providers should be subject to switched access charges. Despite this ruling, the PUC repeatedly found that IP telephony services should not be included in the definition of switched access service and should not be subject to access charges.
- The Commissions from South Carolina, Nebraska, Ohio, Washington, Pennsylvania and Alabama have initiated generic proceedings to consider the regulation of VoIP.
- In arbitration proceedings, North Carolina, Alabama and Kentucky have declined to determine whether IP telephony should be included in the definition of switched access traffic until the service was defined with some certainty or the FCC made some definitive statement.

#### VoIP Public Safety Issues

A leading concern of the explosion of callers using IP telephony is the compatibility of these systems with the emergency 911 system currently in place. As of now, callers to 911 cannot be located as quickly, or at all, using IP technology.

A major public policy concern regarding the proliferation of calls using IP technology is the reduction of revenue available for the Universal Service Fund, a \$6 billion annual program, which is paid through fees on most telephone bills.

The issue of access charges will be a major focus of the incumbents’ argument for regulation of VoIP that uses the PSTN for delivery of the call. There is a distinction between “pure VoIP” which does not touch the PSTN and “POTS VoIP” where IXC’s utilize the Internet for transport only and the PSTN for delivery of the call.

#### **FCC Rulings**

Although both cable modems and DSL provide the same final byproduct – high speed internet service – there is a general regulatory dichotomy between these two services that rests squarely within the federal regulations which distinguish between telecommunications service, cable service, and information service.

Telecommunications services fall under Title II of the Communications Act of 1934 and carry various interconnection, resale and unbundling obligations under the 1996 Act and existing FCC regulations. To varying degrees, they come under the jurisdiction of both the FCC and the states. Similarly, local franchising authorities have limited jurisdiction over cable services under Title VI of the Communications Act, but not over information or telecom services. Information services fall under Title I of the Telecom Act, and provide little, if any, authority to states or local jurisdictions for regulation.

Recently, the FCC has attempted to revisit issues arising from the varied regulatory and statutory classifications of services, as part of a broader goal of comprehensively rationalizing the disparate regulatory regimes in light of the agency's overarching policy objectives and the emerging converged environment for communications services. In rulings and rule-making proceedings launched during the last two years, the FCC has made attempts to clarify the classification and regulatory treatment of telephone (wireline) and cable broadband access services, several court decisions, however, have left certain areas unclear.

#### Telephone broadband services

As early as the FCC's Computer Inquiries initiated in 1966, ILECs that provide basic service are required to unbundle their underlying transmission facilities for the provision of enhanced services on a nondiscriminatory basis, while non-ILEC "enhanced" services providers ("ESPs") are, for the most part, unregulated, and therefore not subject to these unbundling obligations, rate regulation, universal service contributions, or the payment of access charges. Examples of enhanced services include Internet access, web hosting, e-mail, instant messaging, and, more arguably, Internet telephony.

The federal 1996 Act essentially codified the basic/enhanced regulatory classification scheme promulgated in the Computer Inquiries, but replaced the basic/enhanced services distinction with the terms "telecommunications services" and "information services." Consequently, services considered "basic" under the Computer Inquiries are now classified as telecommunications services, and services considered "enhanced" under the Computer Inquiries are now information services under the Act's definitions. The 1996 Act also required much more extensive cost based unbundling of ILEC network elements needed to provide a telecommunications service than was required under the limited requirements for unbundling of the underlying transmission element of an enhanced service at nondiscriminatory rates. The Computer Inquiries are still operative, however, and provide ESPs with the ability to gain access to the ILEC's network, since ESPs are unable to use the unbundling rules of the 1996 Act because those are limited to telecommunications providers.

The definitions of these two terms also have implications for the unbundling and resale provisions in the 1996 Act. The 1996 Act requires ILECs to provide unbundled network elements ("UNEs") at cost-based rates "to any requesting telecommunications carrier for the provision of a *telecommunications service*" (emphasis added). The Act also requires ILECs to "offer for resale at wholesale rates any *telecommunications service* that the carrier provides at retail to subscribers who are not telecommunications carriers" (emphasis added). In light of this statutory language, information services provided by ILECs are excluded from the scope of the 1996 Act's unbundling and resale obligations because they are not telecommunications services. Therefore, if an ILEC service is classified as an information service rather than as a telecommunications service, competitors may be precluded from gaining access to the network elements that comprise the service via the 1996 Act's unbundling and resale rules. Instead, the more limited Computer Inquiries, which are more costly to utilize, would have to be relied upon in order to gain access to the

underlying transmission component of the ILEC's information service.

### DSL

In 2000, the FCC ruled that a DSL service tariffed by GTE was an advanced telecommunications service subject to common carrier obligations.<sup>34</sup> In February 2002, the FCC tentatively concluded in its Wireline Broadband NPRM<sup>35</sup> that Internet access over telephone wires using broadband technologies such as DSL is an information service with a telecommunications component. As noted in the NPRM:

We tentatively conclude that wireline broadband Internet access services – whether provided over a third party's facilities or self-provisioned facilities – are information services subject to regulation under Title I of the Act . . . . Specifically, we tentatively conclude that when an entity provides wireline broadband Internet access service over its own transmission facilities, this service, too, is an information service under the Act. In addition, we tentatively conclude that the *transmission component* of retail wireline broadband Internet access service provided over an entity's own facilities is “telecommunications,” but not a “telecommunications service.”<sup>36</sup>

However, the issue of how the transmission telecommunications component should be treated from a regulatory perspective, i.e. the extent to which ILECs are required to provide resale and unbundled access to the DSL component of a wireline broadband offering, remains a frequent matter of contention among the ILEC and CLEC industries today. In addition, the FCC's recent decision in its Triennial UNE Review Order (“TRO”) also has a direct impact on this issue, since it provided ILECs with relief from unbundling requirements in certain instances for certain markets and certain services. This decision is in limbo, however, with the recent decision on appeal of the TRO issued March 2, 2004, which vacated the majority of the FCC's findings in this regard.

### Cable broadband services

The FCC ruled in March 2002, following its Notice of Inquiry, that cable modem service was an information service and therefore not subject to any of the requirements of a telecommunications service under Title II (unbundling, resale, universal service, access charges), or a cable service under Title VI (franchise fees, customer service standards).

Recent court rulings have thrown into the question the FCC's classification of cable modem service as an interstate, information service. In October 2003, in *Brand X Internet Services v. FCC*,<sup>37</sup> a three-judge panel of the Ninth Circuit Court of Appeals ruled that a cable modem service is a combination of telecommunications service and information service, and vacated and remanded back to the FCC its declaratory ruling classifying cable modem service as an interstate, information service. The Ninth Circuit's decision reaffirmed that court's earlier decision in *AT&T Corp. v. City of Portland (Portland)*<sup>38</sup> on procedural grounds, without re-examining the merits of the case. In *Portland*, the court had found that franchising authorities were preempted from regulating cable

<sup>34</sup> See *GTE Operating Companies Tariff No. 1*, 13 F.C.C.R. 22466, 1998 WL 758441 (1998).

<sup>35</sup> *PROPOSED RULES, Appropriate Framework for Broadband Access to the Internet Over Wireline Facilities*, 67 FR 9232-01, 2002 WL 274748 (F.R.), CC Docket No. 02-33, CC Docket No. 95-20, CC Docket No. 98-10; FCC 02-42, February 28, 2002.

<sup>36</sup> *Ibid.*, ¶¶ 16-17 (emphasis in original).

<sup>37</sup> *Brand X Internet Services v. F.C.C.*, 345 F.3d 1120 (2003).

<sup>38</sup> *AT&T Corp. v. City of Portland*, 216 F.3d 871 (2000).

modem service because it was a telecommunications service under the 1996 Act.

Because the FCC's declaratory ruling classifying cable modem service as an information service was issued *after* the *Portland* decision, the court in *Brand X* found that the FCC decision violated the established law of the *Portland* ruling, and they were bound to uphold it and vacate the FCC's ruling. The FCC has sought to appeal the Ninth Circuit's *Brand X* decision, which therefore leaves this issue currently unresolved. Should the *Brand X* decision be upheld, the FCC could still prevent cable modem services from having to meet the requirements of a telecommunications service under their ability to forbear from applying relevant Title II telecommunications regulations to cable modem service. The FCC has acknowledged in its Declaratory Ruling that they would be very willing to issue such a forbearance to preclude cable modem service being regulated as a telecommunications service.

### **Recent Court Challenges**

On February 12, 2004, the FCC ruled that Pulver.com's Free World Dialup ("FWD") service is an unregulated information service subject to the FCC's jurisdiction. Pulver.com's FWD allows users of broadband Internet access services to make VoIP or other types of peer-to-peer communications directly to other FWD members, without charge. In 2003, Pulver.com filed a petition for declaratory ruling requesting that the FCC rule FWD to be neither a "telecommunications service" nor "telecommunications," and therefore not subject to traditional telephone regulation. The FCC's recent ruling granted Pulver.com's petition, finding that because Pulver.com does not provide the transmission medium, but is merely an Internet applications that facilitates peer-to-peer voice (and other sessions), it is not "telecommunications," not a "telecommunications service," and is exempted from Title II obligations. The FCC noted that its ruling "emphasizes the FCC's long-standing policy of keeping these consumer Internet services free from burdensome economic regulation at both the federal and state levels."

Notably, at the same time, the FCC announced the release of a NPRM to examine issues related to services and applications which make use of IP-protocol, such as VoIP, which it has now deemed "IP-enabled services." Specifically, the FCC seeks comment on whether and how to apply discrete regulatory requirements to these services where necessary to fulfill important federal policy objectives. FCC Chairman Powell emphasized in his comments that "[w]hile IP-enabled services should remain free from traditional monopoly regulation, rules designed to ensure law enforcement access, universal service, disability access, and emergency 911 service can and should be preserved in the new architecture."

## **PART FOUR: NON-DISCRIMINATORY ACCESS**

**“A requirement that a cable television company shall provide its competitors non-discriminatory access to the CATV company’s cable communications system”**

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## **PART FOUR: NON-DISCRIMINATORY ACCESS**

There are two ways in which access to franchised cable operators' systems arises as an issue affecting the state of competition. The first concerns access for multi-channel video programming service providers, which could be characterized as non-facilities based marketers or packagers of programming, and Internet service to the cable operator's lines in competition with its own product offerings. The second involves program producers or programming channel owners' access to the franchised cable company's packages offered its customers.

### **Multi-channel Video Service Provider Access**

A state requirement that a cable television company provide other competing multi-channel video programming providers with non-discriminatory access to the company's cable communications system presents a number of problems. As discussed elsewhere in this report, a similar question has been raised with respect to access to the system by competing Internet access providers.

The foremost consideration in any discussion of is that of federal pre-emption. Provisions in the 1984, 1992 and 1996 Acts touch upon the unique originations and evolution of cable law. Unless otherwise stated in the Act, state and local authority over cable is limited to those specific matters and actions expressly delegated in the Act.<sup>39</sup> The 1972 New Jersey Cable Television Act directed the Board and Office of Cable Television to cooperate and coordinate with all Federal laws, rules and regulations relating to cable television systems and companies.<sup>40</sup>

These antecedents are very different from those applicable to telecommunications. By the very nature of the broadcast or satellite signals retransmitted, cable television services are not readily distinguishable as intrastate or interstate, as has been the case of point to point telephone calls. The products and the business models upon which they are based are different, even though in many senses, both services now are just pumping electrons through pipes.

The origins of telecommunications regulation can be found in the common carrier concept. The regulatory framework for common carrier communications was established as a service independent of content. Cable television service, by itself, is a product marketable solely because of its entertainment content. This means mandated access presents constitutional issues not present in the common carrier mode. Federal Courts have recognized an applicability of the First Amendment to cable television operators, along with the recognition of cable operators as more akin to newspaper publishers than traditional common carriers.

These difficulties were recognized by Congress in the 1996 Act when it created OVS as a voluntary solution with incentives to encourage cable systems to open their distribution lines to other multi-channel video providers. Since the enactment of the OVS provisions, the focus of legal analysis shifted elsewhere, and there was never a final determination from the FCC on the issue.

It important to note the other legal distinctions between the non-discriminatory access provisions applicable to telecommunications companies, and those applicable to cable companies. The use of non-discriminatory access rules within the two industries, while conceptually similar, varies greatly. The telecommunications industry has extensive non-discriminatory access regulations that allow a CLEC or Internet service provider ("ISP") to "piggyback" on parts of the

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<sup>39</sup> *E.g.*, 47 U.S.C.A. § 543(1).

<sup>40</sup> N.J.S.A. 48:5A-2(c), -10.

ILEC's network to provide customers with telephone or Internet services. No such access rights exist with respect to the cable industry absent various rules allowing certain programmers limited access to the channel capacity of cable providers. The telecommunications industry has significantly more non-discriminatory access rules than cable as a result of the longstanding and critical role the industry has played in the development of the Internet and other information networks, and because of the 1996 decision by Congress to open up the local telephone network to competition.

The most important non-discriminatory access rules in the telecommunications industry resulted from the development of the earliest precursors to the Internet. The FCC was concerned with the intersection of data and voice services provisioned over the public switched telephone network. These rules were triggered by the relatively robust competition in the data services market beginning in the early 1960s, coupled with the dependence of data service providers on the ILECs' underlying transmission facilities to provide "enhanced services." Specifically, the FCC was worried that because data services require monopoly-provided telecommunications components as inputs, ILECs that offered data services would discriminate against unaffiliated data service providers by denying them access to these telecommunications components at reasonable rates and on nondiscriminatory terms and conditions. The Commission was also concerned that ILECs would cross-subsidize their unregulated services, such as data processing, with revenue derived from highly-regulated offerings, such as local and business basic telephone service. Consequently, the Commission initiated a series of decisions (often referred to as the "Computer Inquiries"), under which ILECs are required to unbundle their underlying transmission facilities on a nondiscriminatory basis. Thus, these rules allow consumers, for example, to choose from thousands of ISPs for traditional dial-up Internet access.

The 1996 Act went far beyond the Computer Inquiries, initiating the most extensive form of nondiscriminatory access ever encountered in any network industry. The 1996 Act requires ILECs to provide UNEs at cost-based rates to any CLEC wishing to provide a "telecommunications service." The 1996 Act also allowed collocation of competitors' equipment in ILEC facilities and resale of ILEC retail services, provisions not found in the Computer Inquiries, which granted more limited unbundling of the underlying transmission element of an enhanced service at nondiscriminatory rates. Even though the 1996 Act went beyond many of the Computer Inquiries rules, those rules are still operative, for the most part to protect data service providers, which do not benefit from the 1996 Act's unbundling and resale rules.

Reinforcing these regulatory differences between the telecommunications and cable industries, the FCC in 2002 explicitly rejected imposing legacy telecommunications-specific non-discriminatory access regulations on cable companies. The FCC ruled that broadband Internet access provided by cable companies falls under the minimally-regulated information services statutory classification found in the 1996 Act. Consequently, companies wishing to provide Internet service over the cable company's wires are precluded from resorting to the non-discriminatory access provisions of the 1996 Act, which only apply to telecommunications services and not information services. The FCC also declined to apply the non-discriminatory access rules promulgated in the Computer Inquiries—which allow non-affiliated ISPs to utilize parts of the ILEC's network to provide customers with Internet access and other forms of information services—to cable broadband Internet service. Moreover, by confirming that cable broadband Internet access is "interstate," the FCC has further reinforced barriers to state and local regulation of Internet access provided by cable companies.

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## **Programmer Access**

### Leased Access

Federal law already provides some access protections for would-be program providers. The longest standing one is the leased access requirement of the 1984 Cable Act, which requires channel capacity be made available to programmers to purchase time and/or channels. It includes an FCC-administered process for protecting the rights established for programmers and for insuring the programmers are charged fair rates. The dominant program content under this framework is infomercials.

### Operator Affiliated Access

Another purpose of the Act is designed to keep cable operators from favoring affiliated programming services or channels.<sup>41</sup> In New Jersey, a recent example has centered around the issue of whether affiliated programming is being favored in the YES Network dispute. YES Network, a regional sports programmer, unaffiliated with any cable operator, has exclusive rights to cablecast New York Yankee baseball games. Cablevision owns a number of metropolitan area sports teams and cable systems in New Jersey, as well as rights to Madison Square Garden and Fox Sports programming. YES Network reached agreement for its programming to be carried with all cable operators except Cablevision. A dispute arose that ultimately has been settled through arbitration. Arguably, the dispute fueled migration of some customers to the DBS provider.

Another example involved Comcast when they were able to deny operators in New Jersey access to regional sports programming of teams they owned because the programming was distributed to the cable systems by microwave rather than satellite. Recently legislation was proposed in Congress to include all regional sports programming in access provisions.

### Public Education Governmental Access Channels

While federal law specifically permits state or local franchising law to establish local access channels, New Jersey has no statewide minimum public, educational, or governmental (PEG) access channel requirements. These are determined by each municipality during the franchise process, as is the responsibility for daily administration and operation of the channels, and virtually all franchises in the state contain some kind of PEG access channel provision. The Office of Cable Television monitors for compliance with the general federal requirements that these channels be non-commercial and available on a first come, first serve basis. Complaints in New Jersey about the cable operator denying access to these channels are rare. Occasional disputes usually involve local parties and are handled by the Office of Cable Television on a case-by-case basis.

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<sup>41</sup> 47 U.S.C.A. § 628

**CONCLUSION**

Under the mandate provided by Public Law 2003, Chapter 38, this Report is issued and filed by the New Jersey Board of Public Utilities on this Fourteenth day of April, 2004. The Board submits this Report and offers the testimony provided by the public through oral and written comments as an overview of the state of competition in the multi-channel video distribution throughout the State.

Respectfully submitted,

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**APPENDIX**

**Testimony at February 26, 2004 Public Hearing**

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