



RCN Corporation

**Testimony of Peter D. Aquino, President & CEO**

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**Hearing on**

**"Video Competition in 2005 –**

**More Consolidation, or New Choices for Consumers?"**

before the

United States Senate

**Committee on the Judiciary**

**Antitrust, Competition Policy and Consumer Rights Subcommittee**

## Introduction

Good afternoon Mr. Chairman, distinguished members of the Subcommittee. My name is Pete Aquino, and I am the President and Chief Executive Officer of RCN Corporation. We appreciate the opportunity to appear before you today to present our view, as the nation's first and largest wireline cable competitor, on the state of video competition in 2005.

More consolidation in our industry appears to be a given. However, whether that trend results in more choice for consumers, or results in a competition-crushing duopoly, is very much in the hands of Congress and the regulators. The competition policy that Congress sets in the next 18 months will, I strongly believe, determine who gets to dictate the kind of video programming that is available, and at what cost: Will it be consumers that get to choose? Or the biggest cable companies and the former Bells?

To enable the broad-based competition that gives cable consumers real choice, ensuring competitive access to programming and regulatory fairness is key. To that end, I'll be asking you today to consider taking these steps:

- Communicate to the Federal Communications Commission and the Federal Trade Commission the importance of conditioning the Adelphia merger and similar future transactions in ways that mitigate the ability of huge, vertically integrated cable companies to choke off competitors' access to the programming they control;

- Introduce and promote an amendment to the existing program access law to close the so-called “terrestrial loophole” that allows vertically integrated cable companies to circumvent the existing program access rules;
- Request the FTC to open an investigation into the massive, secretive rate discrimination that results in competitors paying vastly more for video programming than do the large incumbents; and
- Reject the former Bells’ demand for franchise relief and other special concessions, and require them to enter their market on the same footing as RCN and other competitors.

We believe that cable choice should rest with our subscribers, as expressed in a fair, open, and competitive marketplace. I hope you agree.

### Personal Background

I started in this industry in 1983 at New Jersey Bell in Newark, New Jersey, right out of college, and a few months before the AT&T Bell system breakup. I’ve now lived through 22 years of competition advancements in the U.S. What I’ve observed is that we’ve come nearly full circle, to a point where Verizon and SBC are close to becoming the new “Ma Bell.”

I left Bell Atlantic in 1995. Even 10 years ago it was clear that broadband, with its capacity to deliver multiple services through a single, highspeed, high capacity pipe, was the future. I believed in the company’s mission to promote broadband, and dedicated my last several years at Bell Atlantic to working on the vision of broadband convergence.

From 1995 to 2000, I was part of the team building one of the first “triple play” voice, video, and Internet networks in Latin America, in 9 cities in Venezuela. We had built broadband in Caracas before many cities in our own country had broadband. Accordingly, I can offer a perspective on competition – and the impediments to competition – that comes from a wide ranging exposure to the conditions that foster innovation in the communications marketplace.

### About RCN

I took the helm at RCN at the end of 2004 when the reorganized company emerged from Chapter 11 proceedings with a new management team, a new Board of Directors, and a much improved balance sheet. In 2005, RCN is the nation’s premier “triple play” wireline broadband provider, offering voice, video, and Internet access services to primarily residential customers, in competition with Comcast, Time Warner, and other incumbent, former monopoly cable companies. RCN currently has more than 850,000 customer connections in major markets on the East Coast, including Boston, New York, the Philadelphia area, Pennsylvania’s Lehigh Valley, and DC, and in Chicago, San Francisco, and Los Angeles. Our current network passes approximately 1.4 million homes, and we have approximately 6 million households under franchise. I am very proud to report that RCN achieved revenues of \$141.4 million in the second quarter of this year, and \$19.8 million in EBITDA.

### Competition Benefits Consumers

I also am proud of the fact the RCN’s presence in the marketplace has produced documented benefits for consumers, including more choice, network upgrades, better

customer service, and a check on ever-rising cable rates. It is well established that competition from both direct broadcast satellite providers, such as the Dish Network and DirecTV, and wireline video providers, such as RCN, pushes down cable rates and improves service for consumers. The FCC has said: "In communities where head-to-head competition is present, the incumbent cable operator has generally responded . . . by lowering prices, providing additional channels at the same monthly rate, improving customer service, [or] adding new services. . . ."<sup>1</sup> Indeed, as the U.S. Government Accountability Office has reported to this Committee, competition from wireline cable competitors like RCN has been shown to be the single most effective constraint on cable prices, resulting in rates that are as much as 15-41% less than consumers pay in non-competitive markets.<sup>2</sup> It is not surprising, therefore, that the cable incumbents often respond to competition aggressively by withholding or threatening to withhold essential programming and by offering our customers predatory discounts that are not made available to the general public.

### New Investment Requires a Fair Opportunity to Compete

Cable competition's success in delivering results for consumers could be dramatically expanded, if Wall Street had confidence that the regulatory environment will foster continued competition. As it stands, however, investors remain extremely

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<sup>1</sup> *Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming*, Eighth Annual Report, 17 FCC Rcd 1244 at ¶197 (2002).

<sup>2</sup> A GAO report on wireline broadband service providers ("BSPs") completed in 2004 said: "The rates for telecommunications services were generally lower in the 6 markets with BSPs than in the 6 markets without a BSP. For example, expanded basic cable television rates were 15 to 41 percent lower in 5 of the 6 markets with a BSP when compared to their matched [demographically comparable] market [without a BSP]." U.S. Government Accountability Office, Report to the Subcommittee on Antitrust, Competition Policy and Consumer Rights, U.S. Senate, *Wire-Based Competition Benefited Consumers in Selected Markets*, February 2004, Highlights, at 1.

reluctant to invest in competitive broadband networks, since many analysts believe that the current regulatory structure – and the changes for which the Bells and cable giants are lobbying – are designed to entrench a duopoly comprised exclusively of the existing mega-cable conglomerates and the new “Ma Bell.” Consequently, RCN is constrained from reaching many households that it would otherwise build to if capital were more available, and consumers are deprived of competitive choice.

Congress now has a window of opportunity to change the perception that the cable market is destined for duopoly. To enable continued diverse competition and encourage additional broadband investment, the investment community must be convinced that new entrants and developing competitors like RCN have a fair shot at delivering their products to consumers. This requires two things: First, as RCN, the direct broadcast satellite (DBS) providers, Verizon, and others have recently argued to the FCC, fair access to programming, which is the lifeblood of competition, must be assured. Second – and here we are at odds with Verizon and the other former Bells – the phone giants must not receive franchising and other concessions that allow them to enter the market with an advantage over existing competitors.

#### Cable Consolidation Threatens Competition

One of the greatest threats to competition is the continued consolidation of the largest incumbent cable companies. Comcast’s and Time Warner’s proposal to acquire the Adelphia cable systems and to swap systems among themselves highlights the trend toward ever greater consolidation in the cable market, and the threat to programming access that such consolidation poses. In these transactions, the 5<sup>th</sup> largest cable operator will cease to exist, and Comcast and Time Warner will emerge as

the 1<sup>st</sup> and 2<sup>nd</sup> largest video programming providers in the country, with combined subscribership of 43.4 million customers, and 46.8% of the market. The Consumer Federation of America and Consumers Union have reported that approximately 1.8 million of the 6.9 million cable subscribers destined to change hands in the Adelphia transactions are “pure transfers between Comcast and Time Warner designed to allow these two firms to consolidate their control over key markets.” Comcast and Time Warner tout the fact that Comcast will become more integrated in Pennsylvania, Minnesota, southern Florida, the Washington, D.C. metro area, and New England, while Time Warner will consolidate its hold on markets in western New York, Ohio, Texas, Maine, southern California, and the Carolinas. By increasing each company’s regional “clusters” of cable systems, these proposed transactions will significantly increase Comcast’s and Time Warner’s ability to use their regional dominance to impair competition from developing in their respective markets. As the only wireline competitor to Comcast and Time Warner in many of their markets, we have seen firsthand the enormous potential for these large cable operators to use their vast market power for anti-competitive ends. The comments RCN has filed with the FCC in the Adelphia proceeding highlight our concerns, especially regarding program access. The FCC has recognized this problem:

[W]e believe that clustering, accompanied by an increase in vertically integrated regional networks affiliated with cable MSOs that control system clusters, will increase the incentive of cable operators to practice anti-competitive foreclosure of access to vertically integrated programming.<sup>3</sup>

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<sup>3</sup> *In the Matter of Implementation of the Cable Television Consumer Protection and Competition Act of 1992*, Report and Order, CS Docket No. 01-290, 17 FCC Rcd 12124 (2002), at ¶ 47 (emphasis added).

The consumer groups and other competitors to cable have raised similar concerns.

DirecTV, in particular, has presented a compelling argument that the proposed Adelphia transactions threaten access to “must have” regional sports programming for competitors and their customers. In its comments to the FCC, DirecTV reported that its analysis showed a merger-induced increase in the Herfindahl-Hirschman Index (“HHI”) for at least 10 of the regional sports markets in which Comcast and Time Warner operate, in amounts well above the threshold for an adverse presumption, ranging from a low of 325 to a high of 837, in markets whose HHIs already indicate a high degree of market concentration.<sup>4</sup> DirecTV correctly points out that RCN cannot be denied fair access to News Corporation-owned regional sports programming, as a result of the conditions imposed on News Corp’s acquisition of DirecTV. Fairness dictates that the same conditions be applied to Comcast and Time Warner in connection with their acquisition of the Adelphia systems given the dramatically increased concentration in regional sports markets that will occur as a result of the proposed acquisitions and system swaps.

Comcast and Time Warner control “must have” regional sports programming in many of our markets. Comcast already has secured a huge competitive advantage in major urban markets like Philadelphia by migrating regional programming to terrestrial delivery, and then denying access to its DBS competitors. RCN’s contracts for Comcast SportsNet (Philadelphia), Comcast Sports Mid-Atlantic, and Comcast SportsNet

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<sup>4</sup> *In re the Applications of Adelphia Communications Corporation, Comcast Corporation, and Time Warner Cable, Inc.*, Comments of DirecTV, Inc., dated July 21, 2005, in MB Docket No. 05-192, at iii and 8-10.

Chicago all expire within the next two years, at which time we also will be at risk to losing this essential, non-substitutable programming.

Congress clearly intended to ensure access for competitors to programming controlled by the largest cable operators. But the existing statute covers only satellite delivered programming, and it has become increasingly easy for regionally clustered cable systems to migrate regional programming to terrestrial delivery. By use of this so called "terrestrial loophole," the largest cable operators are able to circumvent the FCC's program access rules and defeat Congress' intent to make programming accessible for competition. This loophole must be closed.

Even where regional sports programming is being made accessible to competitors, the cost of such programming is prohibitive and increasing. Through a joint venture, Comcast and Time Warner will launch in the spring of 2006 a new channel to carry the New York Mets. With this new channel, the number of channels RCN now must carry in order to provide its New York subscribers with local sports has grown to 4. This will result in an increase of approximately 26% in the rates RCN pays for carriage of New York's sports teams, since RCN will have to pay Comcast-Time Warner for the new Mets channel and RCN must continue to carry the Madison Square Garden channel to provide its subscribers with Knicks and other local games, and yet the Madison Square Garden channel, which currently carries the Mets, is only decreasing its rate by 7%. This 26% figure takes into consideration only the increase in costs for the expansion from 3 regional sports networks to 4. RCN also must continue to carry YES (the Yankees channel) and Fox Sports New York in order to provide its subscribers with full local sports coverage, making regional sports carriage in the New York market

the most expensive in the country. Other local markets, however, seem poised to follow suit.

In addition to regional sports, both Comcast and Time Warner control a large slate of national programming, and have signaled their intention to acquire control over even more. For instance, Comcast has announced deals for the movie libraries of Sony and MGM. Comcast also recently acquired PBS Kids programming. RCN's experience with PBS Kids this past summer provides a perfect example of the problems that occur when "must have" programming is in the hands of a large incumbent cable company.

When Comcast entered into a joint venture that gave it control over popular the PBS Kids video-on-demand programming library, it promptly terminated RCN's ability to provide this programming. Regaining access to the programming was made contingent on RCN's negotiating an expensive technical agreement with Comcast, as well as an affiliation agreement for a new Comcast-affiliated children's programming channel called "Sprout." Comcast significantly delayed these negotiations, so that RCN's customers were denied access to the programming for several months. The result was that RCN's video-on-demand usage of the package that had formerly included the PBS Kids content dropped by 75%. Although RCN was able to eliminate the expensive technical agreement with Comcast, RCN was forced to accept new, more costly terms in order to be able to continue providing this vital children's TV to its subscribers.

In another recent example, Comcast has acquired exclusive control over the National Hockey League's Monday and Tuesday games, which it is airing on its OLN channel. In a play to force competing cable operators that carry OLN to pay increased fees for the channel, Comcast moved the NHL games to a different satellite feed.

According to articles in the trade press, Comcast intended to impose a requirement that only providers with a 40% or greater market penetration rate would be allowed to carry the games – a standard not contained in the OLN contract – which would result in only the largest cable operators' customers having access to the games. Although NCTC, the buying cooperative through which RCN and other smaller cable operators purchase OLN, was able to stand up to Comcast this time, and RCN has now obtained access to the NHL games, the problem was not resolved until shortly before game time on October 10<sup>th</sup>. As a consequence, RCN was unable to complete the necessary transponder switch before the game (a process that ordinarily requires 30-days lead time), and RCN's customers and customers of similarly situated small cable operators across the country were unable to view the first NHL game of the season.

These kinds of problems with access to programming owned by the large cable companies occur regularly, and are continuing to grow. In view of reports that Comcast actively is negotiating for carriage of National Football League and Major League Baseball games, this recent experience with the NHL games is especially disturbing.

#### The Adelphia Merger Highlights Competitive Issues in the Cable Market Generally

Even where the cable giants are granting competitors access to the programming they control, smaller companies like RCN are being placed at a significant price disadvantage. Artificial "volume discounts," unrelated to actual costs, favor the largest cable companies, none of which compete against each other. Even the buying consortiums, such as NCTC, lack the necessary scale to stand up to behemoths like Comcast and Time Warner, who will control access to nearly half of all pay-TV viewers in the country if the Adelphia transactions are approved. Despite RCN's membership in

NCTC, we believe our programming costs, due to discriminatory pricing, are nearly double those of the large cable companies. This is difficult to establish, because programmers impose draconian confidentiality requirements on their rates, and we do not have access to the secret rate cards that set programming prices for the largest operators. What we do know is that roughly 32% of our programming dollars currently go to programmers affiliated with Comcast and Time Warner. As their control over “must have” sports and other programming grows, so too does their ability to raise rates to the point that competitors are simply driven out of the market.

Furthermore, the largest of the cable companies exercise their market power to dictate not only rates, but also how programming will be bundled and promoted. Consumers end up paying for programming they don't want, because it is “tied” with the programming they desire. (The retransmission consent rules result in similar tying arrangements imposed by broadcasters, who now own a substantial number of cable networks.) Programmers dictate that their channels must be included in a particular tier, increasing the overall price of that tier for consumers. Programming is promoted based not on market forces, but on non-negotiable terms dictated by huge companies with monopsony market power. RCN has indicated its willingness to participate in a market trial of themed or mini-tier “a la carte” programming offerings, but currently is precluded from doing so by contractual terms imposed by programmers. Intervention by Congress or the FCC is required if consumers, rather than programmers, are to be given the opportunity to dictate what cable customers get to see.

Finally, the sheer size of the largest cable companies allows them to influence the rates of unaffiliated programming providers. The big cable operators get huge

volume discounts, which then pressures the programmers to make up the financial impact by charging small competitors much higher rates. Because there is no rate transparency currently, we believe an investigation by the FTC is imperative, to fully illuminate the extent of the discrimination and its anti-competitive effects.

### The Bells Shouldn't Get Special Concessions

I know that the former Bells entering the video programming market will face similar problems with program access, and I look forward to working with Verizon and others as we work toward solutions.

On the other hand, RCN is strongly opposed to the special concessions the Bells are attempting extract as a condition of their entry into the broadband video market. We welcome this additional competition from the former Bell telephone companies, which could help to balance the market power of the large cable companies and bring additional choice and benefits to consumers. A big cable MSO / Bell duopoly, however, is not in consumers' best interest. So, it is essential that Congress not succumb to the Bells' siren song and grant unnecessary concessions that will benefit the incumbent phone companies to the detriment of competitive pioneers like RCN.

RCN came into the broadband market in response to Congress' invitation in the 1996 Telecommunications Act, and in reliance on the pro-competitive intent of that Act. RCN negotiated some 130 local cable franchise and open video system agreements when it entered the market, and is operating successfully under more than 100 active agreements today. For this reason, the Bells' position that they need relief from local franchising is, in our view, simply not credible. If RCN could do it, so can the Bells. Although, in the majority of instances, RCN negotiated cable franchise agreements, we

also invoked the open video system regime created by Congress in the 1996 Act, where appropriate. Although this regime was specifically conceived by Congress to enable phone companies' entry into the video programming business, there is no evidence that Verizon or others have made any effort to utilize OVS as a mechanism for market entry. Rather, instead of working with the tools Congress provided in the 1996 Act, and after negotiating only a small handful of cable franchises with local jurisdictions, the former Bells immediately began demanding sweeping, nationwide regulatory relief. This demand for special treatment should not be countenanced.

Local franchising ensures that companies using the public rights-of-way provide a quality service to consumers and cooperate with other competitors to safeguard consumer choice. We believe that working with municipalities and with the companies that already occupy local rights-of-way is beneficial to the community.

Which brings me to a second concern with the way in which the Bells are entering our market. More and more frequently, RCN is being asked to move or rearrange its existing network – at RCN's expense – in order to make room for the Bells on utility poles and in conduits. This simply isn't fair. While we understand the need to cooperate to make optimal use of shared facilities, we believe the Bells should bear the cost of their network deployment – not RCN.

RCN is not asking for special consideration – only a level playing field. Certainly the Bells, with their vast resources, shouldn't get concessions either. If the Bells are granted any of the regulatory relief they are seeking, it will become even more imperative that the problems with access to programming be remedied, if competition is to survive.

### Where Competition Exists, Consumers Are Winning

There is one market currently in which RCN competes with a smaller cable company that does not wield the excessive market power of Comcast, Time Warner, or the former Bells, and that is Lehigh Valley, Pennsylvania. The Lehigh Valley, where RCN competes head-to-head with cable operator Service Electric, is unique in the country in that cable competition has existed there for some 40 years. Service Electric does not control “must have” programming, nor has it received preferences in franchising or rights-of-way access, making the Lehigh Valley market a model of what can occur when the cable marketplace is truly fair, open, and competitive. The data bear out the benefits. RCN and Service Electric share the total number of cable subscribers in the market roughly equally (RCN has about 45% of the market, Service Electric has about 42%), and DBS serves the remaining 12-13% of the market. And, I am pleased to report that customer satisfaction in Lehigh Valley is very high. RCN recently was recognized by the local newspaper as the “Readers’ Choice” for best provider of cable TV, telephone, and Internet services in the Lehigh Valley, Pennsylvania, area.<sup>5</sup> Service Electric was chosen the number one cable operator in the state by the local trade association, the Broadband Cable Association of Pennsylvania.

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<sup>5</sup> The Readers’ Choice Awards are part of an annual poll taken by *The Morning Call* newspaper, with readership of more than 477,000 people during the week in Lehigh, Northampton and Carbon counties, and the surrounding Pennsylvania counties of Berks, Bucks, Montgomery, Schuylkill and Monroe, plus Warren County, New Jersey.

## Conclusion

RCN is asking Congress to help us replicate the Lehigh Valley success story by taking several straightforward steps to keep the marketplace competitive and to ensure consumer choice. We ask that you consider:

- Communicating clearly to the FCC and FTC that the proposed Adelphia transactions must be conditioned so as to require that Comcast and Time Warner give competitors access to programming they control, at rates and on terms equivalent to what they give themselves;
- Imposing similar conditions on any future mergers in the cable industry;
- Enacting legislation to close the “terrestrial loophole,” so that programmers affiliated with the largest cable companies no longer can circumvent the program access rules;
- Requesting that the FTC immediately open an investigation into the rates and terms for video programming to illuminate the current discriminatory pricing structure that favors the largest cable operators and to debunk the myth that these discriminatory rates are justified, and report its findings to Congress prior to the next legislative session; and
- Rejecting the former Bell companies’ request for relief from franchising, and requiring the Bells – not their competitors – to bear the full costs associated with their network deployment.

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On behalf of RCN, I want to thank you Mr. Chairman and members of the Subcommittee for this opportunity to present our views. I will be happy to provide

additional background materials in support of the points I've raised today, and to answer any questions you may have.