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January 4, 2007

The Honorable Kevin J. Martin
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Re: MM Docket No. 92-266

Dear Mr. Chairman:

Having analyzed the Report on Cable Industry Prices ("2005 Cable Price Report") that was released on December 27, 2006, I write to respectfully ask you to correct the record. The public has the right to expect that the agency will collect and disseminate data in a way that is transparent, impartial and credible. Unfortunately, a number of assertions have been made that are not supported by the facts, or, in some instances, by the 2005 Cable Price Report itself. These inconsistencies should be corrected.

1. The decision not to disclose data showing the pricing of cable's multichannel video services on a per-channel basis disserves policymakers and the public. We ask that you reconsider this decision as part of an effort to focus the Commission's time and attention on presenting more and better information, not less.

As we have said for some time, the Commission's annual cable price survey is a very limited and crude instrument for collecting information, and it is essentially obsolete in today's dynamic marketplace. The rate survey's failure to collect data relevant to today's marketplace keeps operators from providing truly useful data because the only pricing information collected comes from rate cards that have little bearing on the real world of discounts and bundling; the survey focuses predominantly on analog channels in a world where close to half of all customers take digital products; and the survey ignores the obvious consumer benefits of the bundling of high speed Internet, digital phone and video services. Indeed, the Commission and the public could obtain better and more useful information from consumer advertising appearing on television and in newspapers in the Washington, D.C. metropolitan area. An analysis of this advertising shows that policy conclusions drawn from the 2005 Cable Price Report are wildly off the mark: we live in a competitive video marketplace today and consumers are already the beneficiaries.

Although it's short-sighted to focus on video pricing alone, there are more obvious ways to measure prices that actually stand up to scrutiny. It is useful for consumers and policymakers to know whether price increases are or are not accompanied by corresponding increases in the quantity and quality of the service or goods being sold. That's why it is important to analyze prices not only on an inflation-adjusted basis but also on a **quality**-adjusted basis.

One way is to simply measure the price per channel as the FCC has done for some time. **And the data clearly show that the real price per channel over ten years has gone down, not up.** A per-channel analysis may be an imperfect mechanism, but unlike the crude rate-card analysis the Commission released, it at least takes into account changes in the quality and quantity of services offered – changes that are relevant, whether or not the channels are also available on an a la carte basis. It adds nothing to the discussion to claim that per channel measurements are useless unless channels were offered individually. Moreover, every serious economist, and even the FCC, has acknowledged not only the value to consumers of bundling channels but also the reality that every operator offers a wide range of choices – not only the basic tier of around 20 channels, but an expanded basic tier and a variety of other analog and digital packages as well.

In any event, as we have made clear before and do so again below, we believe there is actually a better way to measure value to the consumer.

2. The FCC should use consistent pricing metrics when making judgments about different services. To do otherwise leads to conclusions that cannot be supported. The Commission should begin providing more useful information that uses the same quality-adjusted data that it has embraced in its price analyses for other industries such as wireless.

It's particularly ironic that you have invoked the wireless telephone business in your attempt to characterize the competitive nature of cable video prices. You cited two quality-adjusted measures with regard to the wireless industry, average revenue per minute and the Consumer Price Index (CPI) series for wireless telephone services. However, neither measurement is applied by the FCC when evaluating the cable industry.

Over three years ago, we proposed a measure that would take changes in quality or value of cable service into account, based on changes in the amount of *usage* of the service by cable customers. That measure is Price Per Viewing Hour (PPVH), which is analogous to the average revenue per minute metric that the FCC uses to evaluate the performance of the wireless telephone service industry (even though wireless customers cannot buy service in minute increments; rather, they buy "buckets" of minutes). In fact, in the 10th Annual Report on Video Competition, the FCC acknowledged it would "consider PPVH, as well as other measures of quality-adjusted price, in examining the effect of competition on rates."[1] Yet, so far as we can tell, nothing has been done to provide this data for public review. Instead, the FCC, after rejecting a price-per-channel methodology, now has *no mechanism at all* that adjusts for quality.

PPVH can be calculated by dividing the price of the service by the amount of time that an average household spends watching the service. When measured in this quality-adjusted way, the real price of expanded basic cable service has steadily *declined* in recent years.

We calculated PPVH using an expanded basic service price of $43.04[2] divided by 163.729 hours, which is the amount of time per month that the average cable household spent watching basic cable

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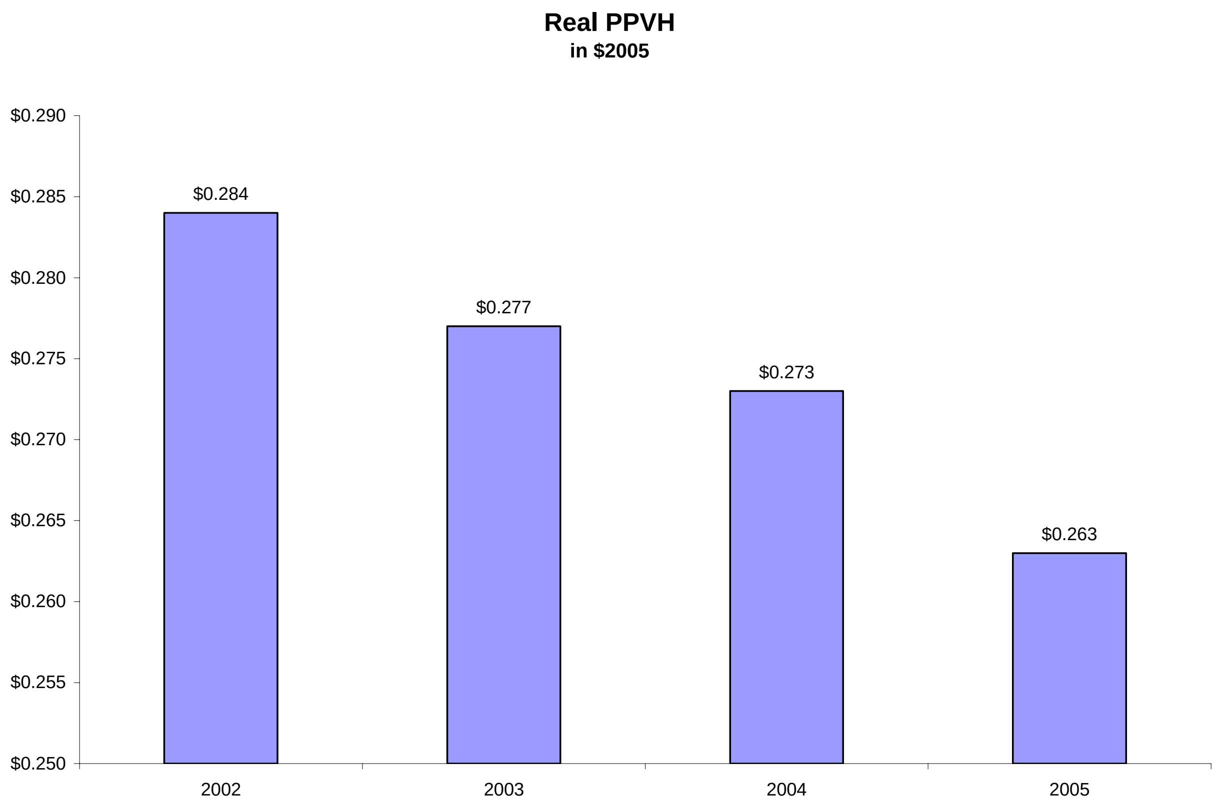
1 FCC Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming – Tenth Annual Report, released January 28, 2004; paragraph 139, page 84.

2 See Attachment 10 of the 2005 Report on Cable Industry Prices

networks in 2005.[3] The resulting PPVH for expanded basic cable service in 2005 was 26.3¢/hour. By comparison, in 2002, the inflation-adjusted PPVH was 28.4¢/hour.[4] The real price also declined in each of the intervening years.



Households are acknowledging and validating the enhanced basic services that cable operators have been delivering by spending a greater percentage of their television viewing time tuned in to basic cable networks. And, as a result, when enhanced basic cable prices are evaluated in a manner that takes such increased usage and value into account, it becomes clear that real prices are moving downward.

3. In your statement regarding the implementation of section 621(a)(1), you said the following: "*Since 1996 the prices of every other communications service have declined while cable rates have risen year after year after year.*" This assertion is false, because it is based on the Commission's use of different types of metrics to measure different services.

Attached to your statement affirming the 2005 Cable Price Report was a graph entitled, "Rates for Communications Services (1995 – 2005)." The graph purports to show declines in prices over time for each of the other communications services. But it appears to use three different methodologies, making any comparison between them invalid. For example, one measure of wireless pricing is

3 Cabletelevision Advertising Bureau 2006 TV Facts; pg. 36 Cable Plus HHs – 37.68 hrs./week converted to months.

4 As noted, this calculation spreads the cost of the cable bill across only the time spent watching basic cable networks since broadcast programming is available free over the air to cable customers. But even if broadcast programming is included in the calculation, the real PPVH still has declined over that three year period.

based on usage (average revenue per minute). Other rates appear to be based on CPI series[5] which explicitly adjust for quality and quantity.[6] For cable, on the other hand, only nominal prices are depicted, with no adjustment for usage, quantity or quality. Had the FCC made a similar adjustment for cable using the nominal PPVH adjustment described above, the graphical increase in cable rates over the past three years would have disappeared.

Curiously omitted from the FCC analysis is any mention of the CPI for Land-line telephone service (Local Charges). Had the FCC graphically depicted the changes in the CPI for Local Telephone Service, the chart would have shown an increase each year since 1995. Also omitted from the FCC analysis is any mention of satellite delivered video services. Approximately 29 million DBS customers would more likely regard satellite service as a closer substitute for cable-delivered video services than wireless services. And it is clear that DBS prices have not been declining.

Finally, I also note that the discussion above assumes a static world of analog expanded basic. While we believe a PPVH analysis for basic cable viewing is more useful than the analysis currently employed, it is still limited in an environment that is increasingly dynamic. How does one value video on demand? Or the use of digital video recorders? Or sophisticated program guides? Or interactive services? Having rejected any quality-adjusted measures, the FCC does not even attempt to address these questions. And yet a moment's reflection shows how truly difficult it is to compare today's extensive array of digital services to the analog services and offerings of a decade ago.

4. Even if Cable Prices Were Increasing, This is Not an Indication of a Lack of Competition.

Finally, we find it necessary to repeat yet again what we've repeatedly explained to the Commission – that even if cable prices, as properly measured, *were* increasing faster than inflation, it would be wrong, as a matter of economics, to conclude that this was an indication that cable operators have market power or that the video marketplace is not fully competitive. In 2002 and 2003, NCTA provided the Commission with papers from two economists, each of whom confirmed that whether or not prices rise faster than inflation tells you absolutely nothing about the absence or presence of competition in a marketplace. As Professor Debra Aron explained,

> [T]he observation that an industry's prices are growing at a rate faster than the rate of inflation establishes no inference about market power. A monopolist who is fully exploiting its market power, as it normally has every incentive to do, would have no reason to increase its price unless its costs, demand, or technology changed. If it is fully exploiting its market power, it does not benefit from increasing its price because *it is presumably already charging the profit maximizing price*, any deviation from which would simply lower profits.[7]

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5 The Bureau of Labor Statistics provides Consumer Price Indexes (CPIs) for major groups of consumer expenditures (food and beverage, housing, apparel, transportation, medical care, recreation, education and communications and other goods and services) and for items within each group, and for special categories, such as services.

6 For the Wireless CPI, "adjustment factors have been developed to adjust for many of the quality and quantity differences between these plans." "How the BLS Measures Price Changes for Cellular Telephone Service in the Consumer Price Index", www.bls.gov/cpi/cpifactc.htm. *See also* www.bls.gov/cpi/cpifactd.htm.

7 Statement of Dr. Debra J. Aron, Director, LECG and Professor, Communications Systems, Northwestern University, Appendix A to NCTA Comments, MB Docket No. 02-145 (July 29, 2002)(emphasis in original).

In a separate paper, Professor Steven Wildman made the very same point.[8]

It really is time for the Commission to stop ignoring this point – and, more importantly, to stop perpetuating the economic fallacy that nominal cable price increases somehow demonstrate a lack of competition in the video marketplace. This is especially so when the underlying premise on whether consumers are getting more value is wrong.

<u>Conclusion</u>

The Congressional mandate to produce the Report on Cable Industry Prices dates from 1992. A decade and a half ago, the multichannel world was very different from today's marketplace – in fact, unlike 1992, today only about 35% of multichannel customers subscribe to the services this report addresses. And it is worth noting that every Commissioner presented with the Report on Cable Industry Prices two weeks ago raised serious concerns over the methodology or the scope and focus of the underlying Survey; and at least two members of the Commission made essentially the same points that I make in this letter about the need to analyze the benefits of the bundle and the growth of the digital consumer base. We therefore request that you both correct the record to address the misstatements I have identified and revise how the FCC collects data to ensure it better reflects the real world.

We stand ready to work with you and the entire Commission to provide meaningful information that contributes usefully to public policy discussions.

Sincerely,

Kyle McSlarrow

cc: The Honorable Daniel K. Inouye
The Honorable Ted Stevens
The Honorable John D. Dingell
The Honorable Edward Markey
The Honorable Joe Barton
The Honorable Fred Upton

Commissioner Michael J. Copps
Commissioner Jonathan S. Adelstein
Commissioner Deborah Taylor Tate
Commissioner Robert M. McDowell

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8 S. Wildman, "Assessing Quality-Adjusted Changes in the Real Price of Basic Cable Service," Appendix A to NCTA Comments, MB Docket No. 03-172 (Sept. 11, 2003).