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<u>EX PARTE</u>

Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

RE: ***Exclusive Service Contracts for the Provision of Video Services in Multiple Dwelling Units, MB Docket No. 07-51***

Dear Ms. Dortch:

The National Cable & Telecommunications Association ("NCTA") has shown, in comments and ex parte filings in the above-referenced proceeding, that it would be both unlawful and, as a matter of public policy, wholly inappropriate and counterproductive for the Commission to bar cable operators from enforcing existing exclusive contracts to serve the residents of multiple dwelling unit buildings ("MDUs").

In a letter submitted yesterday, Verizon attempts to characterize these showings and arguments as "misplaced."[1] As we explain below, Verizon's arguments do not come to grips with the essence of any of NCTA's arguments and provide no basis for the Commission to take the extreme step of abrogating commercial agreements between cable operators and building owners.

<u>First</u>, NCTA has demonstrated that the Commission has no statutory authority to regulate or restrict such contracts and that, in particular, Section 628 of the Communications Act is directed at competitive issues involving "program access" and does not give the Commission broad, roving authority to prohibit any practices that, in its view, unfairly affect competition among competing multichannel video programming distributors.[2] In response, Verizon continues to read Section 628 as a mini-Sherman Act,[3] but it fails to explain why Congress would have placed such broad and boundless powers in a provision whose legislative history

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1 Letter from William Johnson, Assistant General Counsel, Verizon, to Marlene H. Dortch, Secretary, Federal Communications Commission, MB Docket No. 07-51 (filed Oct. 23, 2007) (Verizon Letter).

2 Comments of the National Cable & Telecommunications Association, MB Docket No. 07-51, at 4-6 (filed July 2, 2007) (NCTA Comments).

3 Verizon Letter at 5-6.

indicates a much narrower focus and purpose. The language of Section 628(b) indicates that Congress's concerns had to with competitive <u>access to programming</u>. Section 628's prohibition applies only to unfair or anticompetitive practices that "hinder significantly or … prevent any multichannel video programming distributor from providing <u>satellite cable programming or satellite broadcast programming</u> to subscribers or consumers."[4] What Congress was concerned about was the potential anticompetitive effects of practices that effectively denied such programming to competing MVPDs. Had it intended to prohibit <u>any</u> practices that hindered or prevented an MVPD's ability to compete in the marketplace, it would have said so.

Verizon claims that Section 621 of the Act, which was amended in 1992 to bar exclusive <u>franchise agreements</u>, somehow confirms that exclusive <u>MDU contracts</u> should be viewed as unfair and anticompetitive practices that are barred under Section 628. But, as the Commission itself recognized just four years ago, the competitive effects of MDU contracts are hardly the same as the effects of exclusive franchises. Exclusive MDU contracts and building-by-building competition can, in fact, promote investment, efficiency and competition among competing franchisees in a community.[5] It's possible, as the Commission recognized, that exclusive MDU contracts can be predominantly anticompetitive and tantamount to exclusive franchises where a single MVPD has locked up such a large share of the community's households as to preclude competitive entry. But the Commission found no evidence that this was the case then – and Verizon has offered no evidence that it is the case now. Nothing submitted by Verizon or any other company indicates that competitors have decided to avoid a particular geographic market or to curtail any investment plans as a result of exclusive MDU agreements. To the contrary, as reported in the Wall Street Journal this morning, Verizon "is making significant headway with its $18 billion effort to roll out television and faster Internet service."[6]

Given the substantial inroads being made by Verizon and other phone companies, on top of the already substantial competition cable operators face from the two nationwide DBS providers, there is no basis on which the Commission can conclude that exclusive access agreements have any impact on marketplace competition beyond particular buildings subject to such agreements. As to those buildings, the Commission recognized only four years ago that exclusive contracts are not necessarily anticompetitive and that building-by-building competition to serve MDU residents can promote competition and the interests of the residents. The Commission found then no basis for concluding that exclusive contracts were, on balance, anticompetitive (even though there were competitors, wireline and wireless, to cable at the

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[4] 47 U.S.C. § 628(b).

[5] *Telecommunications Services Inside Wiring*, First Order on Reconsideration and Second Report and Order, 18 FCC Rcd 1342, 1370, ¶ 71 (2003) (*Inside Wiring Order*) ("The parties have identified both pro-competitive and anti-competitive aspects of exclusive contracts. We cannot state, based on the record, that exclusive contracts are predominantly anti-competitive.").

[6] *Verizon's FiOS Challenges Cable's Clout*, Peter Grant and Dionne Searcy, WALL STREET JOURNAL, Page A12 (October 24, 2007).

time).[7] NCTA and other cable operators have shown that there is no evidence that they are in any way impeding competition today.

Second, NCTA demonstrated that, in many cases, cable operators received exclusive rights not only in return for fees required by building owners as a condition for serving the building but also in return for installing or upgrading the building's wiring in order to enable residents to receive high-quality video programming as well as advanced broadband services such as high-speed Internet and telephone service.[8] We showed that it would be extremely unfair – and, in fact, an unlawful "taking" under the Fifth Amendment – to deny operators their investment-backed expectations by prohibiting them from enforcing the exclusivity that they had bargained for.[9]

Verizon ignores this impact and objects to characterizing its proposal as "abrogation" of existing agreements. It prefers to characterize its approach as merely prohibiting enforcement of one term of an existing contract that would now be contrary to public policy, citing cases that allow continued enforcement of contracts where, as one case put it, "'the illegal provision may be severed and the valid portion of the contract enforced.'"[10] Verizon's attempt to mitigate the severity of what it proposes the Commission do on its behalf through semantic distinctions is unavailing.

Verizon is indeed seeking federal agency abrogation of existing contracts, plain and simple, based on a public policy determination that the FCC rejected four years ago and that the majority of states also reject. This would be an unprecedented step for the agency to take, even if the cases cited by Verizon were applicable and its contentions regarding the severability of MDU contracts were correct.

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[7] As NCTA demonstrated, Verizon's argument that its wireline entry changes everything simply ignores the substantial competition present when the Commission decided this issue four years ago. *See* Letter from Daniel Brenner, Senior Vice President, National Cable & Telecommunications Association, to Marlene H. Dortch, Secretary, Federal Communications Commission, MB Docket No. 07-51 (filed Sept. 27, 2007).

[8] This is not a point that has been made solely by incumbent cable operators. Building owners and private cable operators also make the common sense point that a company is more likely to invest in new MDU wiring and provide other consumer benefits if it can be assured of recovering its investment through a limited period of exclusivity.

[9] Verizon attempts to argue that there is no takings issue involved here, but the single case it cites – *Multi-Channel TV Cable Co. v. Charlottesville Quality Cable Corp.*, 65 F.3d 1113, 1123 (4th Cir. 1995) – fails to prove its point. That decision affirmed an award of damages to an incumbent cable operator against a subsequent video provider that was guilty of tortious interference with the incumbent's subscriber relationships. In affirming that decision, the court rejected an argument by the building owner that a provision of Virginia law that prohibited payments to building owners was an unconstitutional taking. But the court's decision that the building owner had no reasonable investment-backed expectation in payment from a cable operator has no bearing whatsoever on the argument that NCTA has made here, *i.e.*, that a cable operator that has negotiated a commercial agreement providing for exclusivity has a reasonable investment-backed expectation in the opportunity to recover its wiring costs from subscribers.

[10] *Transamerica Insurance Co v. Avenell*, 66 F.3d 715, 722 (5th Cir. 1995), *quoting Panasonic v. Zinn*, 903 F.2d 1039, 1041 (5th Cir. 1990).

But Verizon's contentions are not correct. The FCC found in 1997, and affirmed in 2003, that building owners should be permitted to enter into exclusive access agreements, and more than 30 states also allow such agreements. To decide that these lawful agreements, and lawfully-negotiated terms within those agreements, are now "illegal provisions" which can be struck from contracts, without abrogating the contracts is wrong. For it, too, is black letter law that whether a contract is entire or divisible depends upon the intention of the parties. "A contract is indivisible where the entire fulfillment of the contract is contemplated by the parties as the basis of the arrangement."[11] As filings by Charter and others amply demonstrate – and which Verizon nowhere disputes – these exclusive provisions go to the essence of the economic bargain struck with MDU owners. To sever lawful terms would create a precedent that Verizon, recognizes but cannot avoid, by making its erroneous semantic argument here.

Third, NCTA has demonstrated that the unfairness of abrogating exclusive agreements is compounded by the Commission's recent *Sheetrock Order*, which effectively transformed cable "home run" wiring in many buildings into "cable inside wiring" – a regulatory transformation that forces operators to relinquish the wiring to new video service providers, and to do so at a price (replacement cost) that does not compensate them for their investment.[12] Verizon's argument that concerns regarding wiring compensation issues are a "red herring" is wrong. As explained in recent filings by Cox, issues regarding access to a building and wiring of that building are inextricably linked.[13] While Verizon suggests these arguments are a "desperate attempt to distract the Commission," the fact is that NCTA raised concerns about these wiring issues months ago in its reply comments.[14]

A simple example demonstrates the problem. Suppose nine months ago a cable operator signed a five-year exclusive contract in which it agreed to upgrade the wiring in a building. It would have expected to recover the costs of some of that wiring over the five years. If the Commission invalidates the exclusive contract, and residents switch to a new provider, the inside wiring investment that constituted part of the overall investment in the building can be claimed by the newcomer. Indeed, the newcomer can price its offering knowing that it can take the incumbent's wiring – including wiring outside the customer units as a result of the *Sheetrock Order* – at replacement cost, which will be much less than the actual cost incurred by the

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11 *Frankenmuth Mutual Insurance co. v. Escabmia County, Fla*., 289 F.3d 723, 728 (11th Cir. 2002), *citing Wilderness Country Club v. Groves*, 458 So. 2d 769, 771 (Fla. 2d Dist. Ct. App. 1984), *quoting Local No. 234 v. Henley & Beckwith*, 66 So. 2d 818 (Fla. 1953); *see also Ireland v. Craggs,* 56 F.2d 785 (5th Cir. 1932); 12 Am, Jur. 2d, Contracts, § 415.

12 *See* Letter from Daniel Brenner, Senior Vice President, National Cable & Telecommunications Association, to Marlene H. Dortch, Secretary, Federal Communications Commission, MB Docket No. 07-51 (filed Oct. 24, 2007).

13 *See* Letter from Alexandra Wilson, Vice President of Public Policy and Regulatory Affairs, Cox Enterprises, to Marlene H. Dortch, Secretary, Federal Communications Commission, MB Docket No. 07-51 (filed Oct. 24, 2007). As Cox explains, the real estate industry also has made the point that wiring and access issues are intertwined and should be addressed in a comprehensive manner.

14 Reply Comments of the National Cable & Telecommunications Association, MB Docket No. 07-51, at 9 (filed Aug. 1, 2007).

operator nine months ago. This is a real world advantage for Verizon and other competitors, not a "red herring." While the current wiring rules remain in effect, the Commission should not exacerbate the problems created by those rules by also abrogating exclusive access agreements.

Finally, this proceeding ultimately must be viewed in a larger policy context. Four years ago the Commission found that exclusivity had varying competitive effects and concluded that on balance, there was no reason to bar the practice. This view coincided with the positions of the majority of states, which also do not have right of access statutes. Congress considered, and rejected, a right of access provision in the 1984 Cable Act, and the major amending laws of 1992 and 1996 did not change that judgment, despite Verizon's claims as to Sections 628 and 621. And no state that has passed a prohibition on exclusive agreements sought to abrogate existing exclusives.[15] The nation's governors have urged the FCC to delay action given the potential effects of a change on state authority over contracts and real property.[16]

The FCC is, thus, faced with a serious question of federalism in what Verizon proposes and an about-face in policy. It is primarily predicated on unsubstantiated claims by Verizon of being foreclosed from market entry – a "foreclosure" that in less than two years has led to over 500,000 customers. Verizon's pleading fails to make the case to abrogate existing exclusive contracts.

Respectfully submitted,

/s/ Daniel L. Brenner

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[15] *See* Letter from the National Governors Association to Kevin J. Martin, Chairman, Federal Communications Commission, MB Docket No. 07-51 (filed Oct. 24, 2007).

[16] *Id.*