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EX PARTE

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

Re: ***Leased Commercial Access, Development of Competition and Diversity in Video Programming Distribution and Carriage,*** **MB Docket No. 07-42**

Dear Ms. Dortch:

Verizon submits this letter to express its continued concern about proposals by certain parties to modify the Commission's leased access rules, particularly to the extent they would apply to new entrants in the video marketplace.

The current leased access rules were designed for an environment in which vertically-integrated monopoly incumbents possessed bottleneck control to consumers. The rules were not designed with competing providers or new entrants in mind. As currently formulated, those rules impose disproportionate burdens on competitive providers by effectively granting unbundled access to significant amounts of channel capacity at artificially and disproportionately low rates. Some parties' proposals would now result in these rates being slashed further,[1] which would only increase the disproportionate burden on new entrants. And they would do so for no good reason. As we have explained previously,[2] competition rather than regulation is the best mechanism to ensure that

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[1] *See, e.g., See, e.g.,* Gregory Rose, *Estimation of the Costs of Physical Transmission of the Lowest-Rated 15% of Channels on the Analog and Digital Tiers of CATV Providers*, NAMAC et al. Ex Parte letter filed by Harold Feld, Media Access Project, to Marlene H. Dortch, Secretary, FCC, MB Docket No. 07-42 (Nov. 6, 2007) (proposing a maximum annual leased access rate of $.0990 per subscriber).

[2] Reply Comments of Verizon, *Leased Commercial Access; Development of Competition and Diversity in Video Programming Distribution and Carriage,* MB Docket No. 07-42 (Oct. 12, 2007)

consumers have the ability to choose among a wide array of diverse programming options – a fact that is borne out in areas where Verizon is providing video service in competition with the cable incumbents. Accordingly, rather than increasing the regulatory burden as competition increases as some parties propose, the Commission should instead exempt providers from rate regulation for leased access in areas with effective wireline competition in favor of negotiated, market-based agreements such as those that Verizon already has entered.

1. When Congress adopted Section 612 as part of the Cable Act of 1984, it indicated that "[t]he purpose of this section is to promote competition in the delivery of diverse sources of video programming and to assure that the widest possible diversity of information sources are made available to the public from cable systems in a manner consistent with growth and development of cable systems." 47 U.S.C. § 532(a). Thus, the fundamental purposes of this provision were to encourage competition and promote a diversity of information sources.

At the time that Congress adopted leased access requirements in 1984 – and even when it subsequently amended Section 612 in 1992 – Congress was faced with the situation of monopoly cable operators, generally shielded from competition by exclusive and de facto exclusive franchises. These operators, which were vertically-integrated with more than half of the national cable networks as of 1992,[3] had a demonstrated history of abuses aimed at entrenching themselves and extracting concessions from programmers interested in gaining access to their captive customers. Indeed, the larger multiple system operators had used their monopoly status to demand ownership interests or exclusive contracts or both from programmers in exchange for carriage. And for independent programmers who refused to grant concessions or who posed a threat to the cable operator's affiliated programming, the chances of obtaining carriage were slim.[4]

In light of this history, Congress adopted leased access as a "back-stop" so that independent programmers would have a potential avenue for gaining access to customers if the then monopoly vertically integrated cable incumbents refused to provide carriage. In doing so, Congress was acting on the concern that "cable operators might deny access to programmers if the operators disapproved the programmer's social or political viewpoint, or if the programmers' offerings competed with

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("*Verizon Reply Comments*"); Ex Parte letter from Leora Hochstein, Executive Director – Federal Regulatory, Verizon, to Marlene Dortch, Secretary, FCC, MB Docket No. 07-42 (Nov. 14, 2007).

[3] H.R. Rep. No. 102-628, at 41 (1992).

[4] H.R. Rep. 98-934 (1984) (justifying the need for leased access because "cable operators do not necessarily have the incentive to provide a diversity of programming sources, especially when a particular program supplier's offering ... competes with a program service already being provided by that cable system"); S. Rep. 102-92, at 50-53 (1992) (noting that the legislation was intended to address problems of programmers not getting "carried on cable systems without relinquishing control of their product" and the cable industry possessing "undue market power which is used to the detriment of consumers, programmers, and competing video distributors"); *id.* (noting that a person "who controls a monopoly conduit is in a unique position to control the flow of programming traffic to the advantage of the program services in which he has an equity investment and/or in which he is selling advertising availabilities, and to the disadvantage of those services, including local Independent broadcasting stations, in which he does not have an equity position").

those the operators were providing."[5] *ValueVision Int'l v. FCC*, 149 F.3d 1204, 1206 (D.C. Cir. 1998). Even while adopting this regulation, however, Congress recognized that leased access might not be a viable business model for independent programmers, given that it takes away one of the two revenue streams (*i.e.*, licensing fees and advertising) on which programmers typically rely and replaces it with an obligation to pay for carriage.[6] Accordingly, Congress made clear that the leased access regime should "be accomplished in a manner consistent with" and "not undermine" the financial or economic "viability of individual cable systems."[7]

Congress's ultimate objective was to rely on competition rather than regulation to achieve its objectives and recognized repeatedly that intrusive regulation of the cable industry should not occur when competition is present.[8] Indeed, both in the context of the Cable Act more generally,[9] and in Section 612 in particular,[10] Congress emphasized its preference for competition and marketplace solutions over regulation.

2. Whatever the merits of the leased access and accompanying rate regulation rules in the context of vertically-integrated monopolies, those rules do not take into account the very different considerations that apply in areas where competing wireline providers are entering, or the disproportionate effect of that the rules have on new entrants. Fundamentally, where there is no bottleneck control over access to subscribers' homes, the need for regulated leased access in order to ensure "diversity" and the availability of a platform for independent programmers no longer exists, and certainly not in the case of new entrants in the video marketplace. Indeed, competitive providers in particular have every incentive to carry high-quality and diverse sources of information in order to differentiate themselves from, and better compete against, their entrenched, vertically-integrated competitors. Such providers by definition do not have, and have never had, the type of "bottleneck" control that prompted Section 612. Moreover, competitive providers do not carry the type of historical baggage – including a history of exclusive franchises, high levels of vertical integration,

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[5] *See also Turner Broadcasting Systems v. FCC*, 512 U.S. 622, 634 (1994) ("*Turner I*") (noting Congress' concern with effects of "vertical integration" and "horizontal concentration" when it adopted the 1992 Cable Act).

[6] S. Rep. No. 102-92, at 31 (1991) (finding that the "cable industry has a sound argument in claiming that the economics of leased access are not conducive to its use").

[7] H.R Rep. 98-934, at 50 (1984).

[8] S. Rep. 102-92 (1992) (noting its "policy to rely, to the maximum feasible extent, upon greater competition to cure market power problems" and, while "some greater governmental oversight of the cable industry" is appropriate "where no competition exists," "this oversight should end as soon as cable is subject to effective competition").

[9] *See, e.g.*, 1992 Cable Act, § 2(b), 102 P.L. 385, 106 Stat. 1460, at 1463 ("It is the policy of the Congress in this Act to . . . rely on the marketplace, to the maximum extent feasible, to achieve th[e] availability" of a diversity of information sources.)

[10] *See* 47 U.S.C. § 532(a) (noting that a purpose of Section 612 "is to promote competition in the delivery of diverse sources of video programming").

and a documented record of abusive tactics used against independent programmers – that led to the adoption of leased access regulation.[11]

Perhaps the best evidence that competition, rather than regulation, best serves the Commission's interest in diversity and promotes independent programming comes from the channel line-up for FiOS TV, which reveals the clear benefits to, and opportunities for, independent programmers as a result of new entry in the video marketplace. From the beginning and without regulatory compulsion, Verizon has negotiated carriage deals with numerous independent programmers such as The America Channel, the NFL Network, and the Hallmark Channel, in addition to a wide range of international and other niche programmers. Verizon also carries a wide array of educational and minority-targeted programming, including dedicated packages such as Connexion Latina that includes Spanish-language programming, of the type that the leased access provision also sought to encourage. *See* 47 U.S.C. § 532(i). Likewise, FiOS TV includes several low power television stations. And Verizon has a strong incentive to continue to carry such programming in order to distinguish itself from its entrenched competitors.

Verizon's interest in providing a forum for independent and diverse voices is further evidenced by efforts such as its Community Studios project. Through this project, Verizon voluntarily enables groups such as the National Hispanic Media Coalition, the Leadership Conference on Civil Rights, i-Safe, the U.S. Distance Learning Association, the Black Leadership Forum, and the American Association of People with Disabilities to offer programming free of charge to FiOS TV customers on a video-on-demand basis.

In contrast to these types of diverse information sources, the majority of the leased access inquiries that Verizon has received to date have related to infomercials or home shopping networks, not diverse or independent programming.

3. Imposing burdensome leased access obligations on competing providers is not only unnecessary where effective wireline competition is present, but by imposing disproportionate burdens on new entrants it is affirmatively counterproductive to the goals Congress sought to promote through Section 612.

As Verizon has explained previously, rules setting maximum rates for leased access pose particular problems in the context of new entrants. In particular, any rate structure that bases maximum rates on subscriber counts or subscriber revenues is likely to be disproportionately harmful to new entrants in that new entrants have relatively low numbers of subscribers and resulting subscriber revenue, even at a time where their expenses in deploying a network and

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[11] H.R. Rep 98-934, at 31-36 (1984) (noting that leased access requirements were "designed to foster a greater diversity of information sources, and to reduce so-called private bottlenecks that impede the free flow of information"); S. Rep 102-92, at 50-53 (1992) ("Evidence demonstrates that market factors, absent government regulation, are unable to cure cable's bottleneck problems ..."); *id.* (noting the need for Congress to "take reasonable steps to promote diversity" because the number of cable franchises "is necessarily limited"; "In most communities served by cable, viewers have only one cable system available. It is the rare exception to find communities where two systems are competing, especially over a long period of time."); S. Rep. 102-92, at 30 (1992) ("The legislation reported by the Committee is largely designed to remedy market power in the cable industry")

assembling their competitive service are relatively high. Although a new entrant must incur substantial costs to build a network, acquire programming, and otherwise develop its competitive video service, its subscriber counts and revenues will be relatively small as it enters the market. At the same time, a competitive provider will necessarily be competing with an entrenched incumbent, thus limiting the profitability of its offering as compared to incumbents.

Any rate structure that fails to take these attributes into account – including both the current "average implicit fee" approach, which is based in part on subscriber revenues and number of channels, as well as the "flat fee" proposals suggested by some parties here – would force a new entrant to offer leased access at rates that would be disproportionately low. So, for example, the maximum rates set under the current "average implicit fee" calculation start by calculating the subscriber revenue per month for all tiers, and then subtracting associated programming costs. A weighting scheme then accounts for differences in the numbers of subscribers and channels for each tier of service, and the "average implicit fee" is ultimately derived by dividing by the total number of channels on a particular tier of service. *See* 47 C.F.R. § 76.970. In all of this formula, however, nothing accounts for the fact that a new entrant's costs of deployment may be substantial and may not be fully covered by its subscriber revenue. Moreover, for those providers deploying systems that offer substantial capacity and therefore offering a large number of channels (including a wide range of independent channels that may be less expensive to carry than the most popular channels carried by all providers), the "average" fee will become diluted relative to other providers offering fewer (but still likely the popular and expensive) channels. Therefore, even the current rate structure disadvantages new entrants and penalizes providers willing to carry diverse and independent programming.

Some of the new proposed fee structures could result in even lower rates for any provider just entering the market. For example, some proposals would set fees based on a "flat fee" per subscriber. But when a new entrant first enters a market, it has no subscribers and the "flat fee" would therefore be zero. And even as the new entrant begins to grow, this fee would only gradually increase for new entrants as subscriber counts grow. But here again, this low fee would totally disregard the provider's substantial costs in deploying its network and competitive services, or the true value of its network and services.

Moreover, the leased access rules have the further result of penalizing new entrants using efficient new networks. By virtue of having additional channel capacity, the total number of channels that such a provider must make available for purposes of leased access is higher than in the case of incumbents using less efficient technology.

In the case of a new entrant with an efficient next-generation network, the combined effect of these factors may result in a requirement to effectively unbundle a substantial amount of capacity on new fiber networks at artificially and disproportionately low rates. And given new entrants' strong incentive to carry independent or other high-quality programming without any regulatory mandate, the primary recipients of such rules would likely be infomercial providers, the primary users of leased access today. Rules that encourage this result by forcing artificially low rates would, as a result, take away capacity that competitive providers would otherwise be able to devote to true independent programming or to additional HD content. Moreover, by denying reasonable compensation for access to a substantial portion of a provider's next-generation fiber network, such rules would undermine the incentives for providers to invest in such networks in the first place.

The Commission must ensure that its leased access rules have no such effect. Indeed, in Section 612, Congress mandated that "the prices, terms, and conditions of [leased access] use [be] at least sufficient to assure that such use will not adversely affect the operation, financial condition, or market development of the cable system." 47 U.S.C. § 532(c)(1). Consistent with that mandate, the Commission at a minimum should exempt providers subject to effective wireline competition, and particularly new entrants, from rate regulation for leased access channels. Such an approach would do far more to encourage competition and a diversity of information sources than would subsidized leased access rates.

4. Just as policy considerations do not justify burdensome leased access regulation where wireline video competition is present, there also are serious constitutional issues associated with imposing burdensome leased access regulations on new entrants. The Commission should avoid these issues by exempting providers subject to effective wireline video competition from leased access rate regulation.

It is well established that the First Amendment protects video providers' right to offer video programming services. *Turner I*, 512 U.S. at 636; *City of Los Angeles v. Preferred Communications, Inc.*, 476 U.S. 488, 494 (1986) ("*City of Los Angeles*"). Video providers express speech not only through their original programming but also through their editorial decisions over which stations and programs to disseminate. As the Supreme Court has observed, cable providers "communicate messages on a wide variety of topics and in a wide variety of formats." *Turner I*, 512 U.S. at 636 (quoting *City of Los Angeles* at 494 (internal quotations omitted)). Moreover, the First Amendment protects not only the affirmative choice of what to broadcast, but also the choice of what *not* to broadcast.[12]

The Court has likewise recognized the potential First Amendment concerns raised by leased access rules. "There is no getting around the fact that leased ... access [is] a type of forced speech."[13] As the Supreme Court explained in *Midwest Video Corp. v. FCC*,[14] leased access infringes the First Amendment rights of video providers by "significantly compromis[ing] the editorial discretion actually exercised by cable operators," "displac[ing] alternative programming," and "interfer[ing] with their determinations regarding the total service offering to be extended to subscribers."[15]

Regardless of the level of scrutiny, *Turner I*, 512 U.S. at 641 & 661, mandated leased access requirements cannot pass First Amendment muster when applied to new entrants. Congress well understood the First Amendment problems posed by mandated leased access; however Congress

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12 *See, e.g.*, *Bartnicki v. Vopper*, 532 U.S. 514, 532 n.20 (2001) ("'The essential thrust of the First Amendment is to prohibit improper restraints on the *voluntary* public expression of ideas; it shields the man who wants to speak or publish when others wish him to be quiet. There is necessarily, and within suitably defined areas, a concomitant freedom *not* to speak publicly, one which serves the same ultimate end as freedom of speech in its affirmative aspect.'") (citations omitted).

13 *Denver Area Educ. Telecomm. Consortium, Inc. v. FCC*, 518 U.S. 727, 820 (1996) (Thomas, J., concurring in part and dissenting in part).

14 *Midwest Video Corp. v. FCC*, 440 U.S. 689 (1979) (holding that the Commission's leased access rules were not within its then-existing statutory authority).

15 *Id.* at 707 n.17.

concluded, in light of the bottleneck control held by monopoly cable operators at the time, that such regulation of speech was permissible given that such regulation was "designed to foster a greater diversity of information sources, and to reduce so-called private bottlenecks that impede the free flow of information."[16] Incumbent cable operators were the bottleneck that mandated leased access was designed to remedy. *Turner I* at 656-57 (noting the "potential for abuse of this private power over a central avenue of communication" held by a cable operator with "bottleneck, or gatekeeper, control over most (if not all) of the television programming that is channeled into the subscriber's home").

Because this "gatekeeper" or "bottleneck" premise is not present in the case of a new entrant – or for that matter, for any provider subject to effective wireline competition – burdensome new leased access regulation aimed at expanding the use of leased access at the expense of other programming of the provider's choosing or the provider's decision not to speak would be sustainable "only if narrowly tailored to a compelling governmental interest." *Id.* at 653. No such "compelling interest" exists in the context of leased access channels being carried by competitive providers. In fact, as explained above, wireline competition much more effectively advances the interest in a diversity of information sources than does leased access, and expanding leased access obligations on competitive providers would threaten this interest. Moreover, the Commission has recognized that the diversity of information sources continues to increase without such regulation.[17] Rather than meaningfully aiding independent programmers, expanded, subsidized leased access would primarily result in the unbundling of a significant amount of channel capacity for infomercial providers, thus taking up capacity that would otherwise be available for the independent programmers that the Congress intended to encourage.[18]

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[16] H.R. Rep 98-934, at 31-36 (1984) (noting that leased access "does not absolutely ban speech through the cable medium, but requires only some limited sharing of bottleneck facilities on a content-neutral basis" is consistent with the First Amendment); S. Rep 102-92, at 50-53 (1992) ("The Committee believes that the regulation in this legislation does not conflict with the First Amendment principles of free speech and freedom of the press. Evidence demonstrates that market factors, absent government regulation, are unable to cure cable's bottleneck problems and that the Committee's approach of regulating the cable industry-under the Committee's Commerce Clause authority-is directed to the least restrictive means necessary to ensure that the public interest is served."); *id.* (noting the need for Congress to "take reasonable steps to promote diversity" because the number of cable franchises "is necessarily limited"; "In most communities served by cable, viewers have only one cable system available. It is the rare exception to find communities where two systems are competing, especially over a long period of time.").

[17] *See Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Tenth Annual Report, 19 FCC Rcd 1606, ¶ 4 (2004) ("[T]he vast majority of Americans enjoy more choice, more programming and more services than any time in history").

[18] Even if strict scrutiny did not apply in this context, the Court's *Turner I* decision would, at a minimum, mandate the application of "intermediate scrutiny." Under that test, regulations burdening speech must "further[] an important or substantial governmental interest; . . . the governmental interest [must be] unrelated to the suppression of free expression; and . . . the incidental restriction on alleged First Amendment freedoms [must be] no greater than is essential to the furtherance of that interest." *Turner I* at 662 (quoting *United States v. O'Brien*, 391 U.S. 367,

Adopting leased access rules that are disproportionately harmful or burdensome on new entrants in the wireline video market would also violate the First Amendment because "[r]egulations that discriminate among media, or among different speakers within a single medium, often present serious First Amendment concerns." *Turner I* at 559. As discussed above, both the existing "average implicit fee" approach and the "flat fee" proposal discriminate against new entrants – by requiring carriage at a disproportionately low fee – as compared to the incumbents, and the constitutional infirmity of such an approach is compounded by the fact that other competitors, such as satellite providers, are not subject to leased access obligations at all.

In order to minimize these substantial First Amendment concerns, the Commission should exempt all providers subject to effective wireline competition – and in particular all new entrants – from expanded leased access obligations. Such providers by definition do not have the type of "bottleneck" control that would be necessary (though not necessarily sufficient) to withstand constitutional muster.

5. Proposals that would require video operators to offer leased access at artificially low prices would also raise takings issues by failing to appropriately compensate new entrants.[19] As explained above, any rate structure that sets leased access rates based on subscriber counts or revenue is unlikely to fairly compensate a new entrant, given the substantial costs associated with deploying a network and establishing a new video service. This is already true with respect to today's "average implicit fee" approach, and the problem would be compounded in the case of the low "flat fee per subscriber" approach proposed by some commenters. In order to avoid this problem – and consistent with the Commission's general preference for competition over regulation – the Commission should, at a minimum, exempt competitive providers from leased access rate regulation in favor of negotiated, market-based rates.

Leased access forces a video provider to relinquish some portion of its limited and valuable channel capacity to a third party who is entitled to use that capacity on an exclusive and ongoing basis by occupying that capacity with the programming of its choosing.[20] This necessarily means that capacity devoted to those purposes are unavailable for other purposes of the provider's

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377 (1968) (internal quotation marks omitted)). For the reasons discussed above, requiring competitive providers to carry leased access channels at subsidized rates rather than carrying other independent programmers could not satisfy these requirements either. The interests underlying leased access rules are already being met by increased competition, and lowering the rates would primarily benefit infomercial providers at the expense of other independent programmers. In the context of providers lacking gatekeeper access to customers – and in particular for those providers with little or no affiliated programming – these types of burdensome regulations would neither support an important governmental interest nor be sufficiently narrowly tailored to withstand scrutiny.

[19] U.S. Const., amend. V ("[N]or shall private property be taken for public use, without just compensation.").

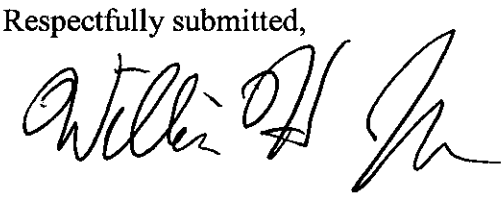
[20] *See* 47 U.S.C. § 532(b).

choosing, including carrying other independent or home-grown programming or carrying additional HD programming. This is a taking for which just compensation is required.[21]

Just compensation requires "the full and perfect equivalent in money of the property taken. The owner is to be put in as good [a] position pecuniarily as he would have occupied if his property had not been taken."[22] In simplest terms, "just compensation" under the Takings Clause means fair market value.[23] But as explained above, both the current "average implicit fee" and the proposed "flat rate" approaches result in highly subsidized rates in the case of new entrants, and thus deny those providers of just compensation for the network capacity being taken from them. Each of these approaches sets the maximum permissible rate by reference to subscriber counts or revenue, and without adequately accounting for a new entrant's investment in deploying its network and establishing its competitive service.

In light of these serious policy and constitutional concerns, the Commission should reject proposals that would require new entrants to unbundle significant amounts of channel capacity at artificially and disproportionately low rates, and instead should exempt competing providers from rate regulation in areas with effective wireline competition in favor of negotiated, market-based agreements.

Respectfully submitted,



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21 *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 421 (1982) (state law that required apartment building owners to permit the attachment to the roofs of their buildings of a small box occupying a mere 1.5 cubic feet of space effects a taking requiring just compensation); *see also Nollan v. California Coastal Comm'n*, 483 U.S. 825, 830-32 (1987); *Kaiser Aetna v. United States*, 444 U.S. 164, 179-80 (1979).

22 *United States v. Miller*, 317 U.S. 369, 373 (1943).

23 *See id.* at 373-74 ("It is conceivable that an owner's indemnity should be measured in various ways depending upon the circumstances of each case and that no general formula should be used for the purpose. In an effort, however, to find some practical standard, the courts early adopted, and have retained, the concept of market value. The owner has been said to be entitled to the 'value,' the 'market value,' and the 'fair market value' of what is taken.").