Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
The Commission's Cable Horizontal and Vertical Ownership Limits	))	MM Docket No. 92-264
	)	
Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992	)))	CS Docket No. 98-82
	)	
Review of the Commission's Regulations Governing Attribution of Broadcast and Cable/MDS Interests	)))	MM Docket No. 94-150

COMMENTS OF

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<u>NATIONAL CABLE & TELECOMMUNICATIONS ASSOCIATION</u>

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The National Cable & Telecommunications Association ("NCTA") hereby submits its comments on the Further Notice of Proposed Rulemaking in the above-captioned proceeding. The Commission should terminate this inquiry by concluding it need not set a limit on the number of channels on a cable system that an affiliated programmer may occupy. It is no longer necessary to apply such limits in order to advance any government interest in ensuring that cable operators do not discriminate against unaffiliated programmers' networks in a way that thwarts competition and diversity. The Commission should also retain the "single majority shareholder exemption" to its cable attribution rules and eliminate the "no sale" (and "no communication") provision of the cable limited partner insulation criteria.

NCTA is the principal trade association for the U.S. cable industry, representing cable operators serving more than 90 percent of the nation's cable television households and more than 200 cable program networks. The cable industry is the nation's largest broadband provider of high speed Internet access after investing well over $100 billion since the 1996 Act to build a two-way interactive network with fiber optic technology. Cable companies also provide state-of-the-art voice service to more than 15 million American consumers.

INTRODUCTION & SUMMARY

Over seven years ago, the United States Court of Appeals for the District of Columbia Circuit set aside the Commission's last attempt to adopt a limit on how many channels can be occupied on a cable system by a video programmer in which the cable operator has an attributable interest. Finding that the "vertical limit restricts [cable operators'] ability to exercise their editorial control over a portion of the content they transmit,"[1] the Court admonished the Commission:

> The FCC presents its 40% vertical limit as advancing the same interests invoked to support its statutory authority to adopt the rule: diversity in programming and fair competition. As with the horizontal rules, the FCC must defend the rules themselves under intermediate scrutiny and justify its chosen limit as not burdening substantially more speech than necessary. *Far from satisfying this test, the FCC seems to have plucked the 40% limit out of thin air*.[2]

Since that decision, the Commission has repeatedly sought comment on how to respond to the court's remand order. Now, once again, the Commission seeks comment on the issue because "[t]he record developed in response to the *2005 Second Further Notice* remains inadequate to support a specific vertical limit."[3] Specifically, as the Commission concedes, "No commenter proposed a specific limit, provided us with evidence to support a specific limit,

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1 *Time Warner Entertainment Co. v. FCC*, 240 F.3d 1126, 1129 ("*Time Warner II*") (emphasis added).

2 *Id.* at 1137.

3 *The Commission's Cable Horizontal and Vertical Ownership Limits*, MM Docket No. 92-264; *Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992*, CS Docket No. 98-82, FCC 07-219 at ¶ 135 (rel. February 11, 2008) ("*Further Notice*").

advanced any methodology that could help us determine a specific limit, or demonstrated a link between any of the harms identified and a specific limit designed to prevent these harms."[4]

It is time for the Commission to abandon its consideration of a vertical ownership cap and terminate this proceeding.[5] It is understandable why the Commission has so far been unable to come up with a set of rules that meet the standards set forth by the Court and by Congress. The statute directs the Commission to adopt ownership rules to, among other things, "[e]nsure its rules reflect the dynamic nature of the communications marketplace." The video marketplace has been evolving and expanding so rapidly that every time the Commission tries to refresh the record with additional comments, the data it collects become stale before rules can be adopted. In the absence of any evidence that a vertical cap, at any level, is necessary to prevent anticompetitive harm, no cap would pass muster even under an "arbitrary and capricious" administrative law standard, much less the heightened First Amendment scrutiny of *Time Warner II*. And if the *2005 Further Notice* elicited no basis to justify a cap, *a fortiori*, the continued decline in vertical integration and the steady growth of competition in the retail market from DBS, telcos and others since then makes it even less likely that any such evidence exists today.

If the Commission adopts a vertical ownership limit despite the lack of record support for such an action, it should reject two related proposals in the *Further Notice*. In the *Further Notice*, the Commission has "tentatively concluded" to eliminate the 75-channel cap applicable to whatever channel occupancy limit it might adopt. The Commission proffers no support for its "tentative conclusion." The proposal to remove the 75-channel cap would dramatically increase

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4 *Id.*

5 As the Commission notes, "[t]his is the Second Further Notice of Proposed Rulemaking with respect to certain aspects of our attribution rules and the Third Further Notice of Proposed Rulemaking with respect to the channel occupancy limit." *Further Notice* at n.3.

the First Amendment burdens on cable operators and thus exacerbate the constitutional problems if the Commission were to adopt any channel occupancy limit. Second, the *Further Notice* tentatively concludes that the Commission should "expand the channel occupancy limit to include video programming networks owned by or affiliated with any cable operator," not just the operator whose compliance is at issue.[6] Such a reading is not supported by the legislative history or Commission precedent.

As for the attribution issues raised in the *Further Notice*, the Commission should adopt its tentative conclusion to retain the single majority shareholder exemption and should eliminate the "no sale" (as well as the "no communication") provisions of its cable limited partner insulation criteria. Both conclusions would be consistent with the *Time Warner II* Court's conclusions on those issues.

I. TO "ENSURE ITS RULES REFLECT THE DYNAMIC NATURE OF THE COMMUNICATIONS MARKETPLACE," THE COMMISSION SHOULD NOT LIMIT CARRIAGE OF VERTICALLY-INTEGRATED PROGRAM NETWORKS

In 1992, Congress directed the Commission to establish "reasonable limits on the number of channels that can be occupied by a video programmer in which a cable operator has an attributable interest" because it was concerned that "vertical integration gives cable operators the incentive and ability to favor their affiliated programming services."[7] This concern was fueled by a perceived "increased vertical integration in the cable industry," and "lack of local competition" faced by cable operators[8] – neither of which is still the case.

[6] *Further Notice* at ¶ 145.

[7] Report of the Senate Committee on Commerce, Science and Transportation, S. Rep. No. 102-92, 102d Cong,, 1st Sess., 25 (1991) ("*Senate Report*").

[8] *Id.* at 24.

A. Vertical Integration of Cable Operators and Program Networks Has Substantially Diminished and Poses No Threat to Competitive Availability of Programming

In 1992, the then-existing level of vertical integration was central to Congress's purpose in directing the FCC to adopt vertical limits. Congress believed that "a few large, vertically integrated firms increasingly control large segments of the domestic cable marketplace," citing data showing that 57% of the then nationally-delivered cable video networks, "have some ownership affiliation with the operating side of the cable industry."[9] It worried that such firms would "favor programming services in which they have an interest, denying system access to programmers affiliated with rival MSOs and discriminating against rival programming services with regard to price, channel positioning, and promotion."[10] And it was concerned that such discriminatory treatment would "reduce diversity in programming by threatening the viability of rival programming services."[11]

But during the next nine years, while the ownership provisions of the Act and the Commission's initial rules were being appealed, vertical ownership in the cable industry dropped precipitously. By January 2002, when NCTA filed comments on the *First Further Notice*, that number had fallen to only 26% – a change that, as Professor (and former FCC Chief Economist) Howard Shelanski noted, "directly reduces the extent to which cable operators could diminish the amount and diversity of programming being offered on the market by discriminating in favor of programming that they own."[12]

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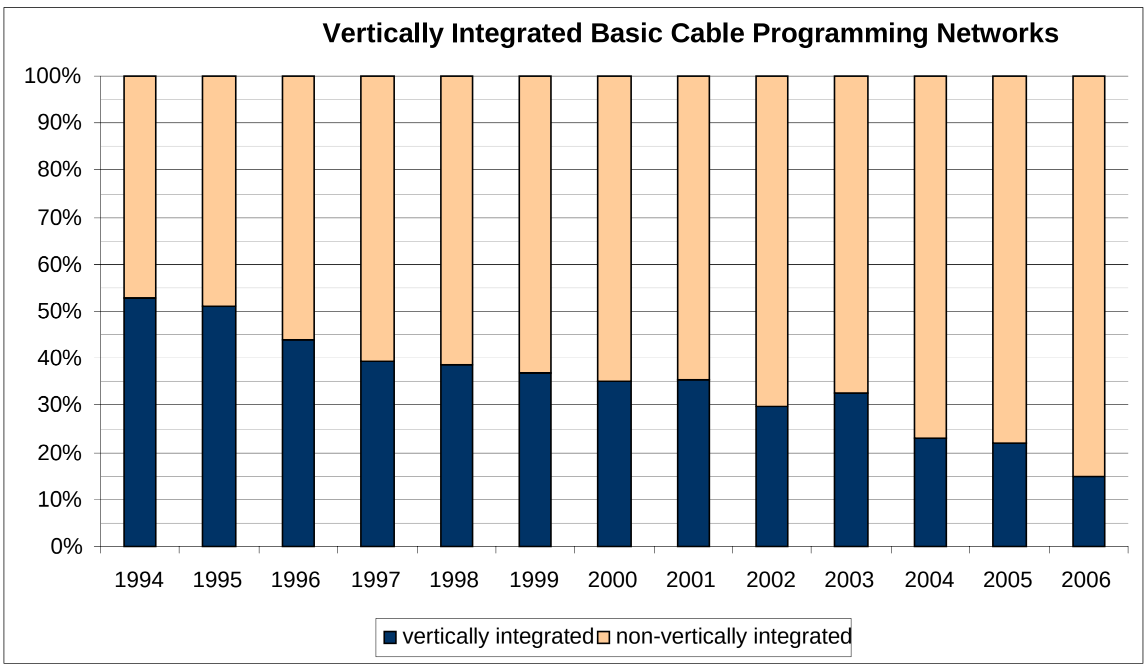
[9] Report of the Committee on Energy and Commerce of the House of Representatives, H.R. Rep. No. 102-628, 102d Cong., 2d Sess. 41 (1992) ("*House Report*").

[10] *Id.*

[11] *Id.*

[12] Statement of Howard A. Shelanksi, attached to Comments and Petition for Rulemaking of the National Cable & Telecommunications Association, CS Docket No. 98-82 at 9 (January 4, 2002), ("*NCTA 2002 Comments*").

In the past several years, vertical integration of programmers and cable operators has diminished even further. According to the most recent FCC data available – the Commission's 13th Annual Report on the Status of Competition in the Market for the Delivery of Video Programming – only 14.9% of satellite-delivered national cable programming networks were vertically integrated as of 2006.[13] In the meantime, the number of satellite-delivered national programming networks continues to increase. In absolute numbers, the *13th Annual Report* "identified 565 satellite-delivered national programming networks, an increase of 34 networks over the 2005 total of 531 networks,"[14] a number which itself was "an increase of 143 networks over the 2004 total of 388 networks."[15]



Source: FCC Annual Video Competition Reports

[13] "FCC Adopts 13th Annual Report to Congress on Video Competition and Notice of Inquiry for the 14th Annual Report," *FCC News Release* at 4 (November 27, 2007) ("*13th Annual Report News Release*"). The *News Release* includes "Specific Findings of the FCC's 13th Annual Video Competition Report," although the text of the Report has yet to be released.

[14] *Id.*

[15] *Annual Assessment of the Status of Competition in the Market for the Delivery of Video* Programming, 21 FCC Rcd. 2503, 2575 ("*12th Annual Report*").

Meanwhile, as the percentage of vertically integrated networks continues to decline, the number of channels available on cable systems has expanded dramatically since 1992. The decline in the percentage of program networks owned by cable operators, coupled with system upgrades dramatically increasing the number of programming channels offered by virtually all cable systems, makes it hard to imagine how any cable operator could significantly harm the competitive flow of programming by favoring networks that it owns. These factors have essentially mooted Congress's core concern in 1992 that large cable operators could constrict the flow of diverse programming to consumers by favoring their vertically integrated networks.

Cable operators do not, of course, have sufficient capacity to carry every program network that seeks to be carried. But as we said in our comments in 2002, "even if every vertically integrated cable operator were to carry every one of its affiliated program networks, there would be more than enough channels to ensure vibrant competition among vertically integrated and non-integrated program networks from multiple, diverse sources."[16] That is even more true today. Therefore, any fear that unaffiliated programming might be squeezed out by program networks owned by cable operators has turned out to be unwarranted.

In any event, as we describe below, vigorous nationwide competition from two strong DBS providers, telephone companies, and other multichannel providers constrains cable operators from discriminating against and refusing to carry unaffiliated program networks that consumers would want to watch.

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[16] *NCTA 2002 Comments* at 11.

B. Competition from DBS, Telcos and Others Eliminates Any Concern That Cable Operators Will Unfairly Refuse to Carry Unaffiliated Quality Programming

At the time of the 1992 Act, cable operators faced competition from many sources of entertainment, including, for example, broadcast stations, video rental stores, live theater and sporting events, motion pictures, and video games. But they rarely faced competition from alternative multichannel video programming distributors that offered customers similar arrays of non-broadcast cable program networks.

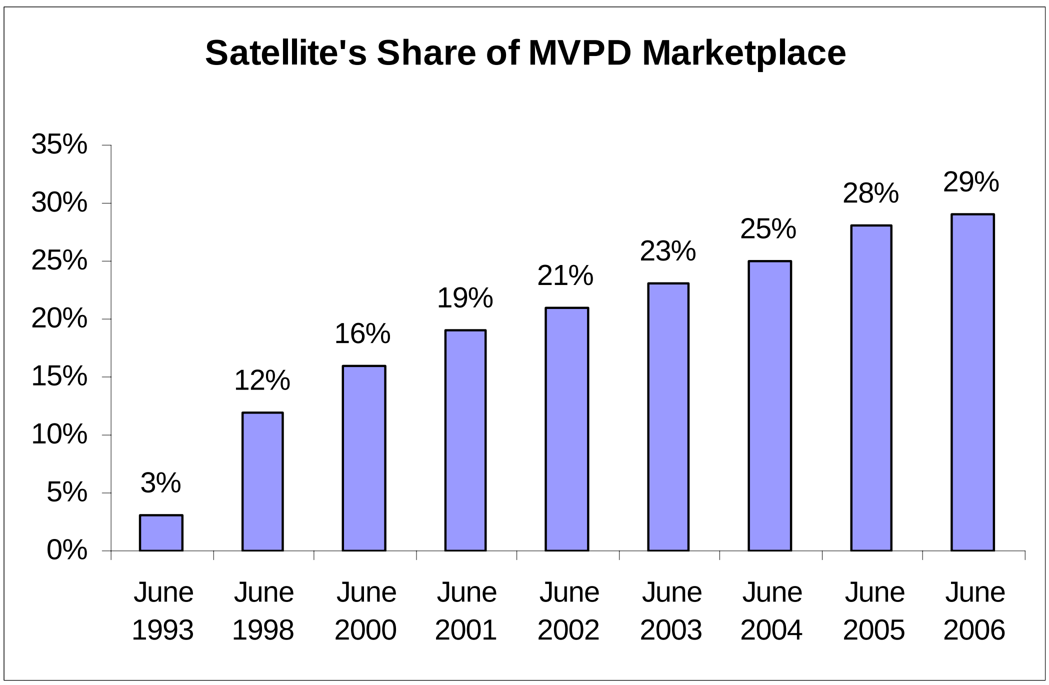
Since 1992, the development of Direct Broadcast Satellite (DBS) service – which was only just beginning when the ownership provisions were enacted – has fundamentally transformed the distribution marketplace. Today, consumers across the nation have at least three competitive sources of subscription multichannel television services: at least one cable operator, and two established DBS providers. The Commission's annual reports on the status of video competition have documented the rapid growth of DBS competition and the fully competitive role that DBS now plays.

In 2004, the Commission concluded in its *10th Annual Report* on the status of competition in the video marketplace that "the vast majority of Americans enjoy more choice, more programming and more services than any time in history."[17] A year later, it further confirmed that "almost all consumers have the choice between over-the-air broadcast television, a cable service, and at least two direct broadcast satellite (DBS) providers" and found that "in some areas, consumers may also choose" to receive service via one or more emerging technologies.[18] Similarly, in its *12th Annual Report*, the Commission concluded that "[c]ompetition in the

[17] *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 19 FCC Rcd 1606, 1608 (2004)("*10th Annual Report*").

[18] *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 20 FCC Rcd 2755, 2757 (2005)("*11th Annual Report*").

delivery of video programming services has provided consumers with increased choice, better picture quality, and greater technological innovation. In particular, the effect of DBS competition has resulted in the addition of networks to cable operators' channel line ups, although it has only lowered cable rates slightly. We find that almost all consumers have the choice between over-the-air broadcast television, a cable service, and at least two DBS providers."[19] The *13th Annual Report* makes similar findings according to the FCC *News Release*.[20] The following chart illustrates the growth of DBS as a viable competitor using data through June, 2006 from the FCC Video Competition Reports.



Source: FCC Annual Video Competition Reports

The implications of this dramatic change in the competitive landscape were already clear to the Commission when it initiated its rulemaking on remand from the Court of Appeals almost seven years ago. As the Commission recognized, "the competitive presence of DBS reduces

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19 *12th Annual Report*, 21 FCC Rcd. at 2506.

20 *13th Annual Report News Release* at 1.

cable operators' incentive to choose programming for reasons other than quality because a cable operator that selects programming on some other basis risks loss of subscribers if high quality programming is available via DBS."[21] The Court of Appeals also understood the relevance and importance of DBS competition. Thus, as the Commission noted in its *Second Further Notice*, the court "required that in fashioning another limit, we recognize that market power depends not only on market share but on the '*availability* of competition.'"[22]

In 2005, the Commission conceded that the evidence before it – including evidence of competition to cable – then could not justify any specific vertical cap.[23] It did so again in the current *Further Notice*. It is difficult to believe that, under current marketplace conditions, the Commission could justify any vertical limit. Indeed, NCTA's most recent Video Competition Comments, filed in November, 2006 (and incorporated by reference), demonstrated anew that significant – and decisionally-significant – changes have occurred in the video marketplace since this remanded proceeding was commenced, let alone since the original cap was adopted.

These marketplace conditions demonstrate that traditional cable operators face a level of competition that will prevent any operator from "unfairly imped[ing] … the flow of video programming from the video programmer to the consumer."[24] As we said in our 2006 Video Competition Comments, "there is no starker proof of a competitive video marketplace than the fact that *nearly 32 million* consumers now subscribe to cable's competitors – DBS, alternative broadband providers, and local telephone companies that are just beginning to enter the

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[21] *Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992*, Further Notice of Proposed Rulemaking, 16 FCC Rcd 17312, 17326-27 (2001) ("*2001 Further Notice*").

[22] *Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992*, Second Further Notice, 20 FCC Rcd. 9374, 9390 (2005) (quoting *Time Warner II*, 240 F.3d at 1134) (emphasis in original).

[23] *Id.* at 9410.

[24] 47 U.S.C. §533(f)(2)(A).

marketplace. That's almost one of every three video subscribers."[25] Sixteen years ago, cable's competitors had only five percent of the multichannel video marketplace. But today, because of fierce competition from DBS and other broadband service providers, their share has increased to more than 33 percent. The following chart, using data as of June 2007, illustrates the competition cable faces from MVPDs other than traditional cable companies.

MVPD Households (in millions)
June 2007

MVPD	**Subscribers**	**Percent of Total**
Cable	**64.3**	**66.41%**
DBS	29.90	30.88%
C-Band (backyard dish)	0.05	0.05%
SMATV	0.91	0.94%
Wireless Cable	0.04	0.04%
Overbuilds (RCN, Knology, Etc.)	1.00	1.03%
Telco Video	<u>0.63</u>	<u>0.65%</u>
Non-cable MVPDs (incl. telco video)	**32.53**	**33.59%**
Total MVPD	96.83	100.00%

Source: SNL Kagan

These are undisputed record facts that the Commission must take into account to comply with the *Time Warner II* admonition that, in fashioning another limit, the FCC must account for the "availability of competition."

[25] Comments of the National Cable & Telecommunications Association, MB Docket No. 06-189 at 9 (November 29, 2006) ("NCTA 2006 Video Competition Comments"). In addition to MVPD competition, the broadcast, home video, and Internet-related industries remain vibrant video competitors, vying for the consumer's eyeballs and dollars.

C. There is No Need to Limit Carriage of Vertically-Integrated Program Networks In Order to Prevent The Problems That Congress Sought to Address

The Commission asks "whether, in today's marketplace, vertically integrated cable operators have an incentive to discriminate unfairly against unaffiliated programming networks that compete against the cable operator's affiliated networks."[26] Today's marketplace assures that cable operators cannot afford to so discriminate. The statute directs the Commission to adopt ownership rules to, among other things, "*[e]nsure its rules reflect the dynamic nature of the communications marketplace*."[27] As discussed above, vertical integration is no longer increasing. Indeed, it has dramatically declined since 1992, while channel capacity has sharply increased. Moreover, the marketplace for the sale of multichannel video programming services is vibrantly competitive.

As a result, vertical integration is no longer accompanied by the incentive or the ability to discriminate in a manner that inflicts anticompetitive harm on unaffiliated programmers or MVPDs – or on consumers. This is because the decline in vertical integration and increase in channel capacity limits the *impact* that vertically integrated companies could have on competition and diversity even if such companies were consistently to favor their affiliates. Even when it had adopted its former rules, at a time when vertical integration was more prevalent, it "recognized that the need for a vertical limit would likely decrease as channel capacity increased" and operators needed to fill more available channels.[28] The declining

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[26] *Further Notice* at ¶137.

[27] 47 U.S.C. § 533(f)(2)(E) (emphasis added). *See also* Conference Report, H.R. Rep. 102-862, 102nd Cong., 2d Sess. at 81 (1992)("*Conference Report*").

[28] *Implementation of Section 11 of the Cable Television Protection and Competition Act of 1992*, Further Notice of Proposed Rulemaking, 16 FCC Rcd. 17312, 17348 (2001).

percentage of programming services owned by cable operators guarantee that cable operators will need to purchase unaffiliated services to fill their expanded channel capacity.

Meanwhile, the established availability of two national DBS providers and other competitors as alternatives to incumbent cable operators throughout the country raises the costs of cable operator discrimination against unaffiliated companies and removes incentives to do so. As the proponents of the 1992 legislation made clear, their concern that vertically integrated cable operators could and would discriminate against unaffiliated programmers was premised on the notion that "cable systems are not subject to effective competition"[29] and that "the guy 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 to the *disadvantage* of those services . . . in which he does *not* have an equity position."[30]

But competition from the DBS providers, telephone companies and others means that a cable operator that makes carriage decisions for reasons other than to provide the most attractive selection of programming will incur a cost in loss of subscribers and revenues to its MVPD competitors. As the Court of Appeals recognized in questioning the Commission's refusal to exempt cable operators subject to effective competition from its vertical limits, "exposure to competition will have an impact on a cable company's ability to indulge in favoritism for in-house productions. After all, while reliance on in-house suppliers offering an inferior price-quality trade-off will reduce a monopolist's profits, it may threaten a competitive firm's very survival."[31] Moreover, the ability to harm an unaffiliated program network is reduced because

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[29] *Senate Report* at 24.

[30] *Id.* at 26 (*quoting* Testimony of Preston Padden (INTV)).

[31] *Time Warner II*, 240 F.3d at 1138.

refusal to carry the network by no means forecloses its access to viewers in the communities served by the cable operator.

In the *Further Notice*, the Commission seeks comments on the "extent to which vertically integrated cable operators have an incentive to engage in strategic, anticompetitive behavior, leading to the foreclosure of entry by unaffiliated programmers."[32] In previous notices, the FCC had requested studies and empirical evidence on how to best set vertical limits. The FCC received no specific recommendations on how to set such a limit but did receive two studies addressing potential vertical foreclosure by cable operators and purporting to show how cable operators favor their own programming.[33] Comcast submitted a rebuttal to these two papers by noted economist Janusz Ordover and Richard Higgins ("Ordover").[34]

The FCC again seeks comments on both academic studies and Ordover's rebuttal. However, while describing in some detail the Chen and Waterman and Kang findings and conclusions, the *Further Notice* gives short shrift to the Ordover rebuttal.

At the outset, the *Further Notice* asks whether "these studies establish that vertical foreclosure is occurring despite *recent* changes in the marketplace."[35] A glance at the studies demonstrates that the answer is an unqualified "no," since neither study takes into account "recent changes in the marketplace." The Kang study is based on data that were already at least six years old at the time it was submitted[36] and is now at least *nine years* old. The Chen and

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32 *Further Notice* at ¶ 137.

33 Chen and Waterman, "Vertical Foreclosure in the U. S. Cable Television Market" (Aug. 7, 2005); Kang "Reciprocal Carriage of Vertically Integrated Cable Networks" (July 28, 2005).

34 Declaration of Janusz A. Ordover and Richard Higgins attached as Exhibit 1 to Reply Comments of Comcast Corporation, MM Docket No. 92-264 (September 23, 2005).

35 *Further Notice* at ¶ 141 (emphasis added).

36 Kang at 13 (primary data source was 1999 Television & Cable Factbook).

Waterman data is now almost four years old.[37] For these reasons alone, given the dynamic MVPD marketplace, neither study can be relied upon to support imposition of a vertical limit even if their other findings were valid, which they are not.

As Ordover demonstrated three years ago, the two academic papers failed to support the need for an ownership cap. Ordover found that neither study provided sound empirical evidence sufficient to demonstrate a significant risk of foreclosure. Moreover, according to Ordover, the evidence included in the studies failed to support the conclusions reached by the authors. Ordover also noted that these studies were either based on false assumptions or excluded key variables. For these reasons too, neither study can be relied upon to adopt any vertical ownership limit, and the Commission should therefore terminate this proceeding without adopting any such limit.

D. In Any Event, the Commission Should Not Eliminate the 75-Channel Cap Nor Should It Expand Networks Subject to the Vertical Limit

If the Commission adopts a vertical ownership limit despite the lack of record support for such an action, it should reject two related proposals in the *Further Notice*. First, in the *Further Notice,* the Commission has "tentatively concluded" to eliminate the 75-channel cap applicable to whatever channel occupancy limit it might adopt.[38] In adopting its 40% channel occupancy ownership limit, the Commission also adopted a 75-channel "cap" on that limit. What that meant was that, "except for 40 percent of 75 channels of activated channel capacity (*i.e*., 30 channels), *there was no limit on the amount of capacity that a cable operator could devote to affiliated programming*."[39] In essence that meant that a cable operator need not devote more than 45 channels (60% of 75 channels) to unaffiliated programming. The Commission

[37] Chen and Waterman at 10 (primary data source was 2004 Television & Cable Factbook).

[38] *Further Notice* at ¶ 143.

[39] *Id.* at ¶125 (emphasis added).

concluded that, in conjunction with that cap, the "40 percent limit on the number of activated channels that can be occupied by affiliated video programming services *struck an appropriate balance* among the goals of reducing the incentive and ability of vertically integrated cable operators to favor their affiliated programming, increasing diversity, and permitting able operators to realize the benefits and efficiencies associated with vertical integration."[40]

In the *Further Notice*, the Commission has "tentatively concluded" to eliminate the 75-channel cap applicable to whatever channel capacity limit it might adopt. The Commission proffers no support for its "tentative conclusion." Indeed, were the Commission to appear "reasonable" by adopting a channel occupancy limit higher than the 40% limit previously rejected by the Court (even though no such limit would be supportable), while also eliminating the 75-channel cap on that new limit, the result would likely be more burdensome on cable operators than the previous 40% cap with a 75-channel limit – despite all the changes in the marketplace.

As noted, the 40% limit with a 75-channel cap limited a cable operator to providing at most 45 channels of unaffiliated programming with the rest of the 30+ channels available for affiliated programming. But with no channel cap, a seemingly more generous 60% limit, for example, would require operators with capacity for 200 channels to carry 70 unaffiliated channels – more than the 45 channels of unaffiliated programming which was the result under the 40% limit. The proposal to remove the 75-channel cap would dramatically increase the First Amendment burdens on cable operators and thus exacerbate the constitutional problems if the Commission were to adopt any channel occupancy limit. It should be rejected.

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[40] *Id.* (emphasis added). *See also Implementation of Sections 11 and 13 of the Cable Television Consumer Protection and Competition Act of 1992,* Second Report and Order, 8 FCC Rcd. 8593-96.

Second, the *Further Notice* tentatively concludes that the Commission should "expand the channel occupancy limit to include video programming networks owned by or affiliated with any cable operator," not just the operator whose compliance is at issue.[41] Such a reading is not supported by the legislative history or Commission precedent. The Conference Report directs the Commission to "[e]nsure cable operators do not *favor their own programming*" and specifies that such limits shall apply to "the number of channels that can be occupied by a video programmer that is owned by a cable operator or in which *the operator* has an attributable interest."[42] And the statute itself mandates that, in adopting its rules, the Commission's objective should be to "[e]nsure that *cable operators affiliated with video programmers do not favor such programmers in determining carriage on their cable systems* …."[43] Plainly, Congress intended that the class of networks that count toward the ownership occupancy limit include only video programming networks owned by or affiliated with the operator whose compliance is at issue, not "any" cable operator – or, for that matter, any MVPD or broadcast network. Suggestions to the contrary in the *Further Notice* find no support in the statute or legislative history.

The Commission's "tentative conclusion" also is inconsistent with Commission precedent. In adopting the vertical ownership rules in 1993, the Commission concluded that, while the "language contained in Section 11(c)(2)(B) of the 1992 Cable Act is not entirely clear, … the most logical interpretation of the statutory language is to apply such limits only to video programmers that are vertically integrated with the *particular* cable operator in question. We believe that this represents the most reasoned approach given Congress' stated objective of

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41 *Further Notice* at ¶ 145.

42 *Conference Report* at 81 (emphasis added).

43 47 USC §533(f)(2)(B)(emphasis added).

encouraging a diversity of voices and preventing unaffiliated programmers from being denied carriage on vertically integrated cable systems."[44] The Commission also emphasized:

> [C]able operators have very little incentive to favor video programming services that are affiliated solely with a rival MSO. Moreover, a vertically integrated cable operator appears to have significantly less power to control the content or distribution of a programming service in which it has no ownership interest. Further, we believe that application of the channel occupancy limits to all vertically integrated programmers, regardless of whether they are affiliated with the particular cable operator, would severely inhibit MSO investment in video programming services, since the mere fact of such MSO investment may restrict carriage of the video programming service on all cable systems. *In the absence of significant empirical evidence of existing discriminatory practices, we see no useful purpose in limiting the ability of cable operators to carry programming affiliated with a rival MSO. Such a restriction would be unduly burdensome on MSO investment in cable programming and would be contrary to the purpose of the statute*. Moreover, we seek to adopt reasonable carriage limits that will balance both the benefits and concerns associated with vertical integration.[45]

These statements are as valid today as they were in 1993 – if not more so. The Commission's "tentative conclusion" to the contrary – unsupported by any record evidence – cannot stand.

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The state of the video marketplace discussed above demonstrates that, as a constitutional, legal and policy matter, limiting the number of channels on a cable system that may be occupied by vertically integrated programmers is no longer necessary or useful to advance the government's interest in ensuring that cable operators do not discriminate against unaffiliated program networks in a way that thwarts competition and diversity. The interest may be a legitimate government interest. But competition among incumbent cable operators, DBS

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44 *Second Report and Order*, 8 FCC Rcd at 8587 (emphasis in original).

45 *Id.* at 8588 (emphasis added). As the Commission has acknowledged, "[b]oth Congress and the Commission have long recognized that vertical integration produces efficiencies in the production, distribution, and marketing of video programming, enabling cable operators to make additional investments in both distribution plant and programming." *Second Further Notice*, 20 FCC Rcd. 9374, 9446 (2005).

providers and other MVPDs is sufficiently vibrant to prevent such discrimination without any channel occupancy limits.

Therefore, because any such limits interfere with an operator's editorial discretion in selecting the array of programming that best meets the interests and demands of consumers in this competitive marketplace, they will inherently – and unconstitutionally – "burden more speech than *necessary*" to further the government's interests.[46] Moreover, since the Commission is charged with establishing "*reasonable* limits on the number of channels that can be occupied by a video programmer in which a cable operator has an attributable interest,"[47] as shown above, under current market conditions, no specific limit could be deemed "reasonable." At best, the Commission would be once again "pluck[ing] the … limit out of thin air."[48] For these reasons, the Commission should terminate this proceeding.

II. IN THE ABSENCE OF REVISITING ITS ATTRIBUTION RULES, THE COMMISSION SHOULD REINSTATE THE "SINGLE MAJORITY SHAREHOLDER" EXEMPTION AND ELIMINATE THE "NO SALE" PROVISION OF THE CABLE LIMITED PARTNER INSULATION CRITERIA

For years, NCTA has urged the Commission to revisit the criteria it uses to attribute "ownership" for purposes of its horizontal and vertical ownership rules.[49] In trying to determine whether any particular level of ownership of cable systems is likely to lead to the sort of "unfair" and anticompetitive conduct that Congress meant to prevent, the definition of "ownership" is obviously a critical factor. For purposes of the horizontal and vertical ownership limits, it makes

[46] *Turner Broadcasting System, Inc. v. FCC*, 520 U.S. 180, 189 (1997) (*quoting United States v. O'Brien*, 391 U.S. 367, 377 (1968)) (emphasis added).

[47] 47 U.S.C. § 533(f)(1)(B) (emphasis added).

[48] *Time Warner II*, 240 F.3d at 1137.

[49] *See, e.g.*, Comments and Petition for Rulemaking of the National Cable & Telecommunications Association, CS Docket Nos. 98-82, 96-85, MM Docket Nos. 92-264, 94-150, 92-51, 87-154 (January 4, 2002).

sense to attribute ownership of a cable system to a particular entity *only if the program carriage decisions for that system can be affected by that entity in ways the rule is intended to address*.

As we have argued in the past, use of the 5% threshold for purposes of implementing those limits automatically (and irrationally) assumes that an entity with an interest in a cable operator and a separate interest in a programming service will have the incentive to attempt to persuade the cable operator to disfavor rivals of the programming service. The over-breadth of the rule is readily apparent. For example, the entity may have $100 million invested in the cable system and only $10 million (through a 5% interest) in a programming network, but the rules irrebuttably presume that the $100 million investment will be subordinated to the $10 million investment. Plainly, it would be economically irrational for anyone to do so.

Moreover, it is not clear that a 5% owner of a cable system would have the ability to persuade the system to make decisions that would favor its 5% stake by foreclosing rival programming services. As shown above, the availability of DBS and other competitive alternatives substantially raises the costs to a cable operator of rejecting programming for any reason other than its attractiveness to customers. Because a cable operator's customers could obtain such programming by switching to one of the DBS providers or some other available competitor, the operator would be significantly inhibited from pursuing a foreclosure strategy. This suggests that even at common ownership levels far greater than 5%, the conduct to which the rule is targeted is unlikely to occur.

More importantly, a cable operator would be particularly unlikely to degrade its optimal programming carriage decisions in order to favor the programming affiliates of a 5% owner. This is so because the benefits and costs of foreclosure are not distributed in the same manner. If the cable operator were to foreclose a rival of its 5% owner, it would itself experience all of the loss (in terms of subscribers that drop cable service in favor of a competitive MVPD as a result of the foreclosure) but none of the gain, because it does not own the favored programmer. It would not make sense for the cable operator to pursue this strategy.

In the absence of a Commission decision to revisit its 5% attribution threshold, it should take whatever steps possible to rationalize its attribution criteria with the real world. In this proceeding, as prompted by the D. C. Circuit's remand, it has an opportunity to do so by retaining the single majority shareholder exemption and eliminating the "no sale" provision of the cable limited partner insulation criteria.

The single majority shareholder exemption had been part of the FCC's attribution rules since 1984 until it was eliminated when the Commission adopted its horizontal and vertical ownership attribution rules in 1999.[50] At the time of its adoption, the Commission recognized that where a corporate entity has a single majority shareholder, it is "neither necessary nor appropriate to attribute an interest to any other stockholder" because "the majority interest holders, even acting collaboratively, would be unable to direct the affairs or activities of the licensee on the basis of their shareholdings."[51] This conclusion still remains valid, and the Commission's elimination of the exemption was correctly called into question by the Court of Appeals. As the Court said:

> Removal of the exemption is a tightening of the regulatory screws, if perhaps a minor one. It requires some affirmative justification, … yet the Commission effectively offers none. Its "concern" about the possibility of influence would be a basis, if supported by some finding grounded in experience or reason, but the Commission made no finding at all. Accordingly, deletion of the exemption cannot stand.[52]

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50 *Implementation of the Cable Television Consumer Protection and Competition Act of 1992*, Report and Order, 14 FCC Rcd 19014 (1999).

51 *Reexamination of the Commission's Rules and Policies Regarding the Attribution of Ownership Interests in Broadcast, Cable Television and Newspaper Entities*, Report and Order, 97 FCC 2d, 997, 1008-09 (1984).

52 *Time Warner II*, 240 F.2d at 1143 (internal citation omitted).

The Commission has "tentatively conclude[d] that the record to date supports reinstating the single majority shareholder exemption."[53] Nevertheless, the Commission asks whether "the goals of the attribution rules – capturing interests that convey the potential to exert significant influence such that they should be counted in applying the ownership rules, while not unduly restricting capital investment, as well as precision and regulatory certainty – would be better served by retaining or eliminating the exemption?"[54] As the record shows thus far, there is no evidence that a minority shareholder in a corporation with a single majority shareholder can exert significant influence or control such that its interest should be counted. In fact, as the Commission observes, "the record in response to the *2001 Further Notice* supports the conclusion that the existence of a single majority shareholder sufficiently attenuates the voting power of minority shareholders such that it should not be a basis for attribution."[55]

The Commission therefore said that "[w]hile corporate management could ordinarily be expected to be influenced by a 5 percent shareholder who is one of the largest shareholders in a widely held corporation,

> we tentatively conclude that corporate management cannot be expected to be significantly influenced by a minority shareholder where there is a single majority shareholder. Further, as a general matter, a majority shareholder has the right to manage and control a corporation. *Therefore, we tentatively conclude that a single majority shareholder, absent a special shareholder agreement, would be able to outvote any minority shareholders on any issue, including the election of the corporation's board of directors*.[56]

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53 *Further Notice* at ¶ 109. Indeed, as the Commission acknowledges, "[i]n the record to date, the majority of commenters support retaining the single majority shareholder exemption. They state that the Commission has received no empirical evidence and little theoretical evidence to support eliminating the exemption, and no evidence of abuse or harm from the exemption." *Id.* at ¶ 108.

54 *Id.* at ¶ 109.

55 *Id.* at ¶ 110.

56 *Id*. (emphasis added).

For the reasons stated above, the Commission's tentative conclusion is correct. The Commission should reinstate the single majority stockholder exemption.

Similarly, the Commission should eliminate the "no sale" provision of the cable limited partner insulation criteria. As the Court of Appeals explained:

> [A] limited partner can secure exemption [from attribution of a limited partnership] if it certifies compliance with certain criteria intended to ensure that the partner "will not be materially involved in the media management and operations of the partnership." The Commission interprets one of these criteria to bar exemption when a limited partner that is a vertically integrated MSO also sells programming to the partnership. This criterion applies even though the limited partner, to achieve exemption, must have certified that it does not "communicate with the licensee or general partners on matters pertaining to the day-to-day operations of its video-programming business."[57]

The Court correctly questioned the necessity for this "no sale" criterion, saying it "bears no rational relation to the goal, as the Commission has drawn no connection between the sale of programming and the ability of the limited partner to control programming choices."[58] It continued:

> Of course a programmer might secure contract terms giving it some control over a partnership's programming choices, but, given the independent criterion barring even communications on the video programming business … exercise of that power would seem to be barred. Even if it weren't, the bargaining opportunity would depend on the desirability of the partner's programming, *not* on its status as a partner. The FCC does not even offer a hypothetical to the contrary.[59]

On remand, the Commission received few comments on this issue. However, rather than simply eliminate the "no sale" criterion, the Commission seeks comments with respect to the court's conclusion "that the no-sale criterion bears no rational relation to the goal" of ensuring

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[57] *Time Warner II*, 240 F. 3d at 1143 (citations omitted).

[58] *Id.*

[59] *Id*. (citation omitted, emphasis in original).

that the limited partner will not be materially involved in the video-programming activities of the partnership.

As the Court recognized, the sale of programming to the partnership by a limited partner does not provide the limited partner with the ability or the incentive to influence the partnership to make specific decisions, particularly because of another insulation criteria which requires that the limited partner have "no communication" on video programming issues. As the Court said, a programmer might secure contract terms giving it some control over a partnership's programming choices, "but, given the independent criterion barring even communications on the video-programming business, … exercise of that power would seem to be barred."

On this point, the Commission asks whether a limited partner selling programming would be unable to influence or control the partnership's programming choices because of the prohibition on communications with respect to the day-to-day operations of the video programming business. It asks whether influence deriving from the "dual status as a program supplier and limited partner"[60] could somehow be exercised without communications. It seems clear that the ban on communications effectively moots the need for the "no sale" criterion. It is hard to see how "influence deriving from the dual status as a program supplier and limited partner "could be exercised without communications."

Even if both the "no sale" and "no communications" criteria were eliminated *in toto*, appropriate safeguards would remain to insulate the limited partner from critical programming decisions. As the *Time Warner II* Court concluded, even in the absence of both a "no sale" and "no communications" criterion, "the bargaining opportunity [of the limited partner] would

[60] *Further Notice* at ¶ 119.

depend on the desirability of the partner's programming, *not* on its status as a partner."[61] Therefore, the Commission should adopt its own suggestion to eliminate the "no communications" insulation criterion with respect to programming sales.

For these reasons the Commission should eliminate the "no sale" criterion as well as the "no communications" criterion from its cable limited partnership insulation criteria.

CONCLUSION

For the reasons stated above, the Commission should terminate its inquiry into "vertical ownership" limits, retain the "single majority shareholder exemption" to its cable attribution rules and eliminate the "no sale" (and "no communication") provision of the cable limited partner insulation criteria.

Respectfully submitted,

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61 *Time Warner II*, 240 F.3d at 1143 (emphasis in original).