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

In the Matter of	)	
	)	
Annual Assessment of the Status of	)	CS Docket No. 01-129
Competition in the Market for the	)	
Delivery of Video Programming	)	

COMMENTS OF THE
NATIONAL CABLE & TELECOMMUNICATIONS ASSOCIATION

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The National Cable & Telecommunications Association ("NCTA"), by its attorneys, hereby submits its comments in the above-captioned proceeding. NCTA is the principal trade association of the cable industry, representing cable operators serving over 90 percent of the nation's cable households, cable programming networks, and manufacturers of cable equipment.

INTRODUCTION AND SUMMARY

Each year, the Commission has the opportunity to step back and review the status of competition in the marketplace for the delivery of video programming. And each year since the annual reporting began in 1994, the Commission has witnessed a steady progression – indeed marked changes – in the video programming options available to the American public beyond cable television. The Commission has acknowledged this trend year-after-year in its annual reports to Congress. We believe there is ample evidence now for the Commission to conclude that video competition has fully taken hold.

There is no denying that cable faces a very different environment than it did eight years ago. In 1993, the video marketplace comprised primarily over-the-air broadcasting, cable television, C-band satellite receivers, video rentals, and movie theaters. Direct Broadcast

Satellite (DBS) entered the picture and changed the landscape forever. With a rich array of digital channels that include the most popular, widely carried national cable networks and exclusive programming, DBS has attracted cable customers to its service in large numbers. Whatever policymakers and industry observers thought about DBS in its early years – as largely a niche service of rural or high-end households – today DBS is a fully-realized alternative to cable.

This reality is borne out by constraints on cable's pricing. Cable price increases have moderated significantly during the two plus years of cable rate deregulation, according to the U.S. Department of Labor's Bureau of Labor Statistics (BLS). <u>The latest BLS statistics show that increases in cable price index in the last 15 reported months exceeded inflation by less than 1 percent.</u> Indeed, cable rate increases (as measured by BLS data) have shrunk significantly since 1999, with full-bore DBS competition – and despite rate deregulation – compared to 1996-1999, when rates were still fully regulated.

Cable and DBS, along with other video providers, are battling it out, home by home, customer by customer. This house-to-house competition, launched by the 1996 Telecommunications Act, is exactly the result Congress had hoped for – more choices for consumers and a significant moderation in price increases even while viewers have benefited from a dramatic increase in quality and quantity of cable programming.

This reality is also borne out by service competition. The cable industry has responded to DBS by accelerating the rollout of digital cable services with dozens of new programming networks, pay-per-view and other services. Even in the face of escalating costs and substantial investments in maintaining and upgrading facilities, the cable industry has spent more and more on improving and developing new programming.

This year the competitive battle has intensified. Over the last year, DBS providers have waged a stepped-up national marketing campaign to further narrow the gap between the two services. And they have renewed exclusive programming deals, formed strategic alliances with various companies to offer interactive television, and introduced two-way broadband services. Cable companies have responded with wide-scale deployment of digital cable programming and equipment, the development of local and regional programming, and the introduction of video-on-demand and other broadband services.

Indeed, for the first time, Broadcasting & Cable magazine this year added satellite providers to its annual ranking of multiple system operators. And they ranked in the upper tier. As the trade magazine noted:

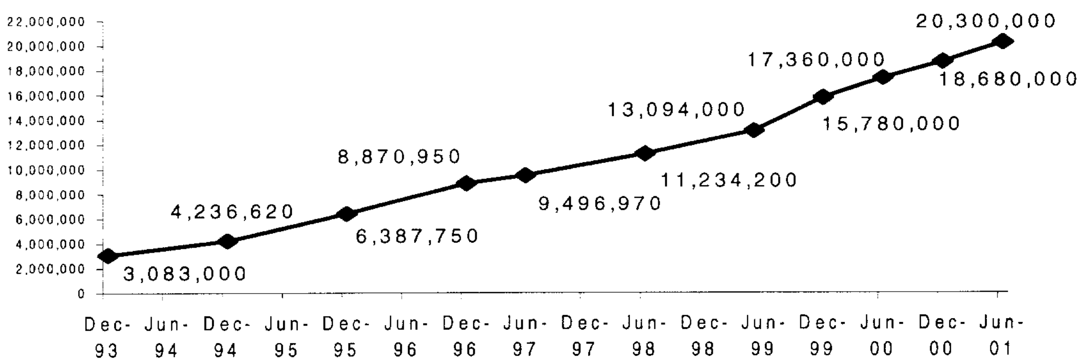
> The magnitude of DBS' continuing surge is one of the starkest patterns that emerges from Broadcasting & Cable's annual compilation of the Top 25 MSOs.
>
> This year, for the first time, we're including Echostar and DirecTV in what has historically been a list of cable operators.
>
> Previously, the compilation had noted the DBS providers in a sidebar.
>
> But that distinction is becoming increasingly irrelevant. DirecTV and Echostar have grown to become the third and eighth largest multichannel video providers, respectively.
>
> And while, even after six years, some Wall Street players speak of DBS as "maturing", the DBS segment, compared with cable, is a quickly maturing teenager.[1]

As DBS continues to sign up more and more customers, the number of consumers that now obtain multichannel video programming from a company other than their local cable operator has swelled to over 20 million – almost 23 percent of multichannel video subscribers

[1] "Cable slows, DBS sprints", Broadcasting & Cable, June 4, 2001 (emphasis added).

(compared to 17.36 non-cable MVPD subscribers in July 2000). Consumers have choices nationwide among competitive MVPDs.

Growth in Non-Cable MVPD Households
December 1993 – July 2001



Source: December 93-June 00: FCC Fourth and Seventh Annual Reports; December 2000 and July 2001: NCTA estimate based on Kagan and SkyREPORT data.

Meanwhile, other well-financed competitors have entered the marketplace, spurred by new economic incentives and economic imperatives to engage in the provision of video programming. Despite a slowing economy this year, the urge to explore ways to combine conventional multichannel video with digital broadband technology options is driving telecommunications companies of all stripes – from traditional local exchange carriers to utility-based start-ups. As technologies converge over broadband facilities, video increasingly intersects with telephony and data services, including interactive TV, Internet access and other advanced services.

Broadband overbuilders are acquiring franchises and concentrating their resources in high-density major cities already under construction where they can get the most bang for the buck against incumbent cable operators. Telephone companies are introducing new very high-speed digital subscriber line (VDSL) technology, which delivers digital video programming over existing fiber optic and copper wire telephone lines. SBC and other telephone companies, which are already marketing DBS and wireless video, are looking at ways to offer video-on-demand and other subscription services on their upgraded networks.

Cable still has the largest share of multichannel video customers, but its share of multichannel subscribership does not mean that cable can exercise significant market power. To the contrary, as NCTA pointed out in previous annual inquiries, where a fully substitutable product, such as DBS, has the capacity to challenge an incumbent in almost 100 percent of the nation, a precipitous decline in the incumbent cable operator's share of subscribers is not necessary to show that DBS's presence is constraining any exercise of market power by cable operators.[2]

The incumbent may be retaining its share precisely <u>because</u> it is vigorously competing by offering prices and services that respond effectively to its competitors.[3] That is exactly what is happening. As the evidence below demonstrates, the time is ripe for the Commission to clearly find that multi-channel video competition has taken hold and is here to stay.

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2 NCTA Comments at 2-3, 1999.

3 <u>See</u> Annual Assessment of the Status of competition in the Market for the Delivery of Video Programming, Fifth Annual Report, Separate Statement of Commissioner Michael Powell, 13 FCC Rcd 24284 (1998) ("<u>What must be understood is that market share alone does not support the conclusion that a given cable operator is exercising market power to the detriment of consumers</u>.")(emphasis added).

I. COMPETITION IN THE PROVISION OF MULTICHANNEL VIDEO PROGRAMMING IS NOW WELL-ESTABLISHED, AS ALTERNATIVE VIDEO AND BROADBAND PROVIDERS CONTINUE TO GROW

A. Direct Broadcast Satellite Is A Firmly Entrenched, Continually Expanding Competitor

As noted above, DBS enjoyed immediate advantages over other providers when it entered the marketplace – a national footprint, a national advertising strategy, statutorily guaranteed access to programming, and digital technology enabling the provision of hundreds of channels of digital video, and CD quality sound. All it lacked was the ability to retransmit local broadcast stations. With the passage of the Satellite Home Viewer Improvement Act (SHVIA) in 1999, this last impediment to DBS's full flowering was removed as Congress authorized DBS companies to retransmit local broadcast signals into their market of origin (local-into-local). As of the end of 2000, DirecTV and Echostar provided local TV signals to a combined total of over 61 million television households in 41 markets.

Even before SHVIA's passage, DBS was growing every year by leaps and bounds. Moreover, the competitive delivery of video programming was given a further path toward irreversible change when Congress passed the Telecommunications Act of 1996. As the Commission notes, the Act established "a pro-competitive, de-regulatory national policy framework" for the telecommunications industry that was designed to expand consumer choice; encourage investment in new technologies; and speed the introduction of advanced services, including digital television. The Act's deregulation of cable rates freed cable companies to move ahead on long-delayed investment in new and innovative technology, new and improved programming and customer service. And it provided a regulatory environment for alternative multichannel video providers to thrive and to expand into new areas.

As evidence of increased competition, over 20 million consumers – almost 23 percent of multichannel video subscribers – now obtain multichannel video programming from a company other than their local cable operator. This reflects an increase of over 2.9 million consumers (16.9%) over a year ago. In contrast, five years after passage of the 1996 Act, the regional Bell companies still control 94 percent of all residential telephone lines. If anywhere near 23 percent of households were receiving their telephone service from someone other than the incumbent local exchange carrier, the Commission, Congress and consumer groups would be elated.

Subscribers to Multichannel Video Program Distribution (MVPD) Services
July 2001

	Subscribers (in Millions)	Percentage of MVPD Subscribers
DBS	16.07	18.10
C-Band	1.02	1.15
MMDS	0.70	0.79
SMATV	1.50	1.69
Local Telephone Companies	0.35	0.39
Broadband Competitors	0.66	0.74
Total Non-Cable	**20.30**	**22.86**
Cable	**68.49**	**77.14**
TOTAL	**88.79**	**100.00**

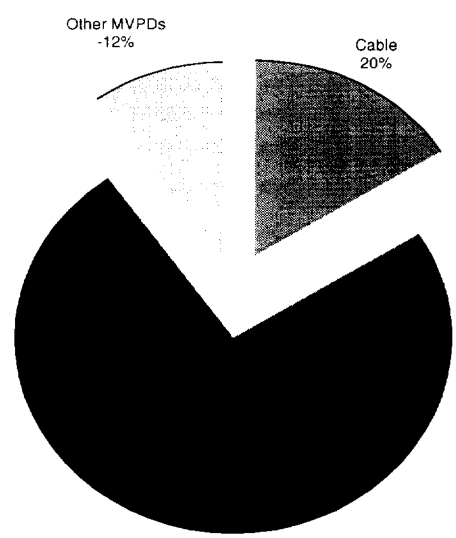
Source: NCTA Research Department estimate based on data from A. C. Nielsen, Paul Kagan Associates, Cable World, SkyREPORT, and public reports of individual companies.

DBS, in particular, has solidified its success with a period of high growth and ambitious plans for new services. Between July 2000 and July 2001, the number of DBS subscribers jumped from 12.5 million to over 16.0 million, a 28 percent annual growth rate. With 10 million customers nationwide, DirecTV has more subscribers than all but two cable operators – AT&T

and AOL Time Warner. The DISH Network (Echostar) has 6 million customers and is bigger than all but five cable companies.[4] While this year's growth projections have been revised somewhat, largely attributable to a slowing economy, analysts are no less bullish on DBS' future.[5]

Echostar is adding 460,000 new customers <u>every quarter</u>.[6] The 11th largest cable operator in the United States serves only about 460,000 subscribers <u>altogether</u>. By the end of the year, Echostar could generate about 1.7 million new subscribers.

Distribution of New Multichannel Households Between July 2000- July 2001



Source: NCTA estimate based on Sky Report, A.C. Nielsen, Paul Kagan data

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4 "Echostar customers top 6 million", CNET News.com, June 11, 2001.

5 Pegasus Communications, the third largest DBS provider has focussed on rural areas and now has approximately 1.5 million subscribers. It is poised for substantial growth in both video and broadband services with the introduction of its new broadband Internet service, Pegasus Express. With its strong subscriber base, Pegasus has been viewed as a likely acquisition target for DirecTV. "Pegasus Spreads Its Wings", BusinessWeekOnline, May 4, 2001.

6 "Cable slows, DBS sprints", Broadcasting & Cable, June 4, 2001.

The total number of multichannel customers continues to grow, increasing by over 3.52 million July 2000 from 85.20 million to 88.79 million in July 2001. Meanwhile, cable's share of multichannel subscribers has decreased from 79.62% to 77.2% over the past year.

Satellite penetration (including C-Band satellite service, which reaches approximately 1 million subscribers nationwide) now exceeds 16 percent of all television households in the United States. Aggregate national numbers tell only part of the story. As of April 2001, DTH penetration exceeded 15 percent in 40 states, 20 percent in 30 states, 25 percent in 13 states, 30 percent in 5 states, and 40 percent in 1 state. The Commission should find that effective competition is now well established in these states. While the definitions section of the effective competition statute, Section 623(l)(1)(B), refers to "franchise area" and not states, it is evident that DBS is available, marketed, and accepted as a competitive alternative to cable in these areas. It would be reasonable for the FCC to presume that effective competition is present in all franchise areas located in states with statewide DBS penetration exceeding the statutory 15% threshold.

States With Direct-To-Home (DTH) Dish Penetration of Fifteen Percent or More (April 2001)

STATE	% OF TVHH with DTH
Vermont	41.27
Montana	38.71
Wyoming	33.69
Mississippi	32.74
Arkansas	30.37
Idaho	28.56
North Dakota	28.48
North Carolina	27.98
Kentucky	27.26
Missouri	26.54
West Virginia	26.20
South Carolina	26.02
Utah	25.56
Texas	24.88
New Mexico	24.70
Indiana	24.63
South Dakota	24.57
Tennessee	24.09
Alabama	23.84
Georgia	23.31
Virginia	23.23
Oklahoma	23.20
Maine	22.65
Iowa	22.53
Colorado	21.78
Wisconsin	21.37
Arizona	21.27
Nebraska	21.12
Oregon	20.64
Kansas	20.49
Minnesota	19.91
Michigan	18.40
Louisiana	18.11
Florida	17.58
Washington	17.12
Ohio	16.28
New Hampshire	15.89
Nevada	15.87
Illinois	15.62
California	15.37

Source: SkyTRENDS SkyMAP, April 1, 2001; www.skyreport.com

In the face of this remarkable growth, the once widely touted idea that DBS is just a niche video player, targeted to certain upscale consumers who want more premium channels and sports programming or rural audiences who cannot not get cable service, no longer holds up. The high up-front equipment costs that presented a disincentive for some to subscribe to DBS have all but disappeared – from $700 six years ago to little or nothing today. For example, Echostar currently offers new subscribers a free DISH 500 system, including professional installation in return for the purchase of a one-year program package.[7] Moreover, as noted above, in 1999, Congress made it possible for the DBS industry to retransmit local broadcast stations, widely viewed as the last legal impediment to DBS' continued growth, with the passage of the Satellite Home Viewing Improvement Act.

DirecTV and DISH Network are taking on cable companies with "competitive prices, pick-your-team sports programming and, just recently, two-way Internet service."[8] In particular, as in past years, DirecTV and Echostar are going head-to-head with cable nationwide with advertising and marketing efforts aimed squarely at existing cable subscribers in both urban and suburban communities. The cable industry has directly responded to the competitive spur of DBS's multiple digital channels with digital cable offerings. Their marketing war has only heated up in 2001. DISH Network, for example, runs ads urging customers to "just say no to cable." It recently announced a new national promotion, beginning August 1, 2001, where new customers can sign up for the service and get 118 channels and free installation for only $9.00 a month for one year. Cable companies have taken the offensive with dish buy-back programs.[9]

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7 See www.dishnetwork.com/content/promotions/index/html.

8 www.bizjournals.bcentral.com/journals/high_tech, San Jose Business Journal, July 10, 2001.

9 "Cable puts emotion into its satellite fight; dishes win the first round, but digital feeds make cable attractive", Advertising Age, April 6, 2001. See "DBS 'Win-Backs' Are Winning Over Ops", Multichannel News, July 30,

DirecTV spends an estimated $60 to $80 million annually on advertising and DISH Network spends millions on print and radio ads comparing itself to cable.[10] The message, as indicated in the following Washington, D.C. advertisement, is to get cable customers to switch to DBS.

Source: Washington Post, July 13, 2001.

2001 (discussing Adelphia, Charter, AT&T Broadband and other company experiments with dish buy-back programs.)

[10] Id.

On July 30, 2001, DirecTV unveiled its "most aggressive promotion to date" – its fall national promotion and advertising campaign, which will feature NFL stars in national television spots highlighting the 2001 NFL Sunday ticket package.[11] New customers who purchase a DirecTV system and subscribe to NFL Sunday ticket will receive $300 worth of free programming. The five-week advertising campaign will include both national television and print ads in 41 markets. This shows that exclusive sports programming continues to be a volatile area in the competition between DBS and cable. Beginning in July 2001, cable operators acquired Major League Baseball's "MLB Extra Innings" package and the National Basketball Association and National Hockey League packages previously only available to DirecTV customers.[12] But DirecTV countered with a multi-year extension of its baseball package through 2003 and, as noted above, still holds exclusive rights to the "NFL Sunday Ticket" through 2002 and had a nationally exclusive "Mega March Madness" package (NCAA Men's Basketball tournament) again this year. DirecTV's senior vice president of programming acquisitions recently said, "I think competition will be good for the packages," and "there will be more general promotion of the package to viewers not familiar with the concept."[13]

B. DBS Competition Has Acted to Constrain Cable Prices

Despite intense capital spending in recent years and escalating programming costs (particularly higher sports rights), cable prices have remained relatively stable on a per-channel basis. This constraint on cable price increases, despite higher input costs, is the result of competition from DBS and others, which tempers every decision an operator takes on services

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[11] "DirecTV Unveils Fall National Promotion and Advertising Campaign", Press Release, July 30, 2001; "DirecTV Dishes Up New Marketing Campaign", Wall Street Journal, July 30, 2001.

[12] "Games Still the Thing for DirecTV", Multichannel News, June 4, 2001

[13] Id.

and prices. Data from the FCC and GAO show that the price per channel of cable's video services has actually declined since 1986 when adjusted for inflation (from 69 cents per channel in December 1986 to 66 cents per channel in July 2000). Meanwhile, between 1996 and 2000, the cable industry spent over $36 billion on basic and premium programming – roughly 75 percent more than the $20.6 billion it spent during the previous five years.

While per channel prices have remained stable, overall prices have increased in the five years since enactment of the Telecommunications Act of 1996 due to the addition of new channels. But what is telling is that in the two years since the deregulatory provisions of the Act took effect – and as DBS competition became most intense – those increases have significantly diminished.

Since cable was deregulated in March 1999 – even with double-digit cost increases for programming (as the quality and quantity of cable channels have increased) and for substantial investments in maintaining and upgrading facilities – the cable price index has risen just slightly over inflation. The U. S. Department of Labor's Bureau of Labor Statistics (BLS) publishes a "CPI-U Cable" statistic monthly that tracks overall cable pricing, nationwide, defined as a cable price index, as a subset of its broader "CPI-U All Items" index, which is the generally-accepted national inflation index. From March 1999 to March 2000, the cable index rose 4.62 percent, while the overall inflation index rose 3.76 percent. In the 15 subsequent months (March 2000 to June 2001), the cable index rose 4.95 percent while the All Items index rose 3.97 percent. In short, for the past 15 reported months, cable price index increases have exceeded inflation by less than one percent.

These figures are particularly remarkable in light of cost pressures on cable operators. The FCC's complementary numbers, using different time periods and measurements, indicate the price moderation that has occurred during a period of escalating costs faced by cable operators. The Seventh Annual Video Competition report found that cable prices rose slightly higher than inflation from June 1999 to June 2000. It also reported capital expenditures by operators for upgrading of cable facilities increased by 89.3 percent between 1998 and 1999, and license fee costs were up 12.2 percent between June 1999 and June 2000. In the previous two Video Competition reports, covering 1998-99 and 1997-98, license fee cost increases faced by operators were reported increasing by 14.6 percent and 18.4 percent, respectively. And capital expenditures increased 13.2 percent and 21 percent, respectively.

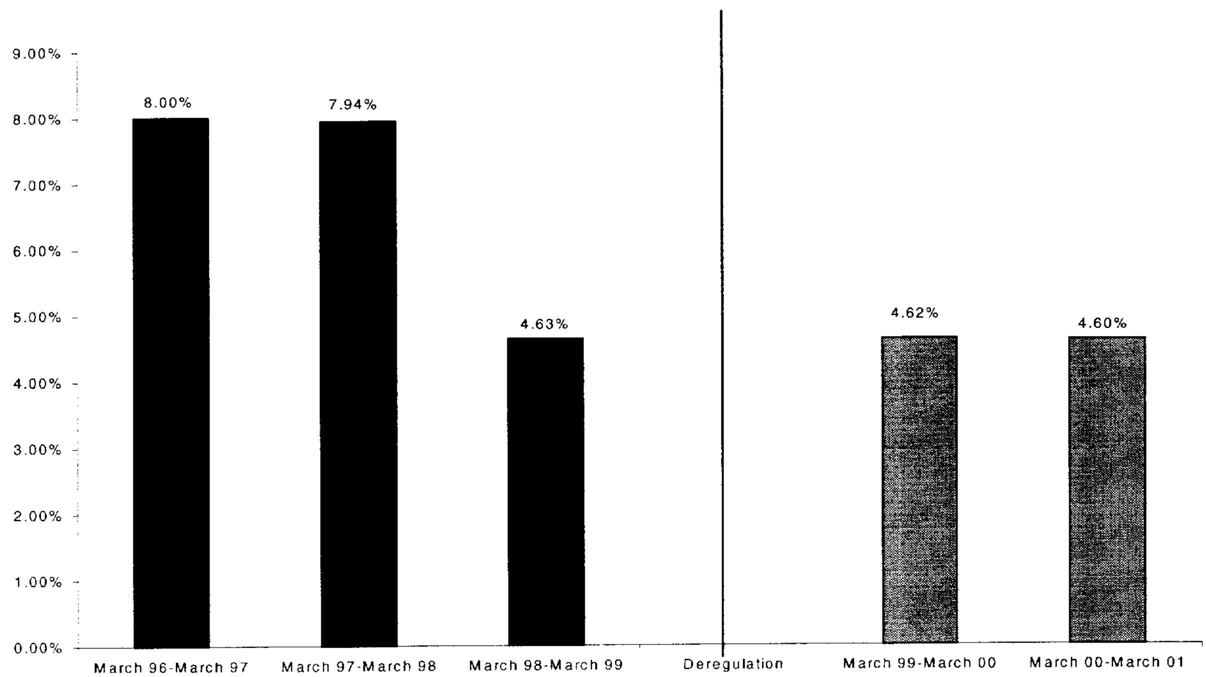
Another way to see the constraining effects of the new DBS competition is to examine rates under regulation and deregulation. One might argue that 1999's deregulation would have ushered in faster rates increases. The opposite, however, has been the case.

Increases in the cable price index were significantly larger from 1996 to 1999 while rate regulation was still in effect than in the last two years after rates were deregulated in 1999, according to BLS. During the first three years after enactment of the 1996 Act – March 1996 to March 1999, the cable price indices went up 8.00%, 7.94% and 4.63%, respectively each year during a period of relatively low inflation.[14] (See chart on next page.) The cable price index increases during those years, still subject to rate regulation, had to be justified by documented cost increases in programming and other "external cost" factors, and all required government approval. From March 1999 to March 2001, a deregulatory era, however, the cable price index rose 4.62% and 4.60% respectively each year, <u>a much slower climb</u> during a more inflationary

[14] The cable price index increased from 207.6 in March 1996 to 224.2 in March 1997. Between March 1997 and March 1998, the index increased from 224.2 to 242.0. Cable's price index increased from 242.0 to 253.2 between March 1998 and March 1999. During the three years between March 1996 and March 1999, the All Item index increased 2.76%, 1.37% and 1.73% respectively each year.

period.[15] Deregulation and competition spawned by the 1996 Act appear to have produced exactly what Congress had hoped for – more choices for consumers and a significant moderation in price increases even while viewers have benefited from a dramatic increase in quality and quantity of cable programming.

Annual Increases in Cable Price Index
Pre and Post Deregulation



Source: Bureau of Labor Statistics

Further, in spite of increasing costs, some cable companies are seeking new customers with significant price reductions. AT&T Broadband, for example, is offering a national promotion by dropping its price for basic cable and expanded basic from $37.49 a month to $19.95 a month through the end of this year.

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[15] Between March 1999 and March 2000, the cable price index increased from 253.2 to 264.9. The cable index rose from 264.9 in March 2000 to 277.1 in March 2001. The All Items index from March 1999 to March 2001 was 3.76% and 2.92% respectively.

Meanwhile, cable customers are paying higher and higher local fees and taxes as part of their monthly cable bill – fees that are not attributable to the cost of the programming and are not generally required to be charged by DBS providers. A typical Comcast cable bill in Washington, D.C., for example, breaks down as follows: $11.43 for basic service; $22.44 for expanded basic, for a monthly service total of $33.87. Added on is $5.20 in fees (including $3.38 gross receipts tax, $1.78 franchise fee, and $.04 FCC regulatory fee) for a total of $39.07. Customers pay more than 15 percent in fees and taxes above the base amount of their cable bill, fees that do not attach to DBS service.

In sum, an accurate picture of cable prices should take into account the foregoing factors. DBS competition, in particular, is exerting a measurable impact on cable pricing, even as cable systems face double-digit upgrade and programming cost increases. Cable price increases have slowed dramatically since deregulation while consumers are enjoying the benefits of a dramatic increase in the quantity and quality of cable programming.

C. DBS Is Aggressively Pursuing Competition with Cable and Other Broadband Providers in Two-Way Data and Interactive Television

In addition to pushing hard on its video programming packages, the last year is marked by DBS' plans to enter the bundled video, two-way data and interactive television arena. As cable undertakes the deployment of video-on-demand and interactive services as a component of its service offerings, the two major DBS providers have accelerated their plans to upgrade their systems to new Ka-band satellites and have struck strategic alliances with interactive companies.[16] DBS is also targeting Internet customers with the advantage (over cable and DSL) of immediate nationwide availability of broadband service.

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[16] "DBS Wields ITV as Weapon vs. Cable", Cable World, April 16, 2001.

DISH Network launched Starband Internet service at the end of 2000. This system offers consumers a single dish for two-way high speed Internet access combined with hundreds of channels of television programming. Echostar has embarked on a plan to compete with cable, DSL and other providers, notably taking control of StarBand, in July 2001.[17] In addition to using the Ku-band, it plans to initiate next generation, higher power two-way Internet service using Ka-band satellites. Echostar's DISH Network PRO 501 receiver enables customers to receive interactive television services and the company recently unveiled a satellite television receiver that incorporates a personal video recorder (PVR) that will simultaneously record and play back full-quality digital video.

DirecTV has been offering broadband data service via satellite for several years with its DirecPC service, which is marketed with its DirecTV television service. Last year, DirecTV announced plans to augment its video-programming package with a two-way broadband service now called DirecWAY. And in October 2000, DirecTV also announced the launch of DirecTV Interactive in conjunction with Wink Communications and Thomson and has deals with AOL TV and Microsoft to offer interactive enhancements to television programming.

Eddy W. Hartenstein, DirecTV Chairman and CEO, said that "adding the two-way DirecPC capability to the DirecTV service is a direct response to consumer demand for integrated entertainment and information products and services."[18] He believes that offering two-way broadband Internet services in combination with DirecTV services using a single antenna "will enable our customers to add broadband services while continuing to use their existing set-

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[17] "Echostar to Take Control of StarBand; McLean Company Gets $50 Million", The Washington Post, July 12, 2001.

[18] DirecTV Press Release, April 27, 2000.

top boxes to receive their DirecTV service," and "that this will appeal to many of our 8.3 million existing customers, and will be an incentive for new customers."[19] This service is expected to launch in 2002.

According to some analysts, the future looks bright for broadband satellite service. The Carmel Group, for example, projects satellite broadband service to surge from approximately 490,000 customers this year to 8.6 million by 2008,[20] citing satellite's cost-effective natural footprint advantage over cable and DSL and its ability to serve an entire continent or the entire globe with the flip of one switch. Once the rural base is established, another analyst projects that DBS will penetrate urban and suburban areas with broadband satellite service just as it did with video customers.[21]

DirecTV's management certainly believes it. In a recent interview, Hartenstein said, in response to a question about how much growth is left in the DBS business, "there is no question that to get to 25 to 30 million homes in the first half of this decade is achievable, and we'll get more than our fair share of it."[22] He noted that those interested in merging with Hughes DirecTV have been attracted to its strong growth potential on "not only the television side, but satellite-delivered broadband side as well." And as to DBS's future as a competitor to cable, Hartenstein said:

> the last differentiator was local channels, and we've got the solution for that now. We'll go to more channels, more markets later this year when we get the first of our two spot-beam satellites up, and it will only keep getting better after that. . . . we've always been a step ahead of cable. We are still ahead, and we'll leap-frog

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[19] Id.

[20] "Ka-band Data Services Won't Stay on the Farm", Multichannel News, June 25, 2001.

[21] Id., (quoting Jose del Rosaria, Frost & Sullivan strategic analyst); see also "Internet in Orbit - Satellite-based Internet access grows up", ZDNet, July 3, 2001.

[22] "DirecTV's Hartenstein: Over 10 Million Served", Multichannel News, , June 25, 2001.

over them yet again when we complete our local channel build-out and add these program-synchronous interactive services.

Similarly, after a year of dramatic subscriber growth, Echostar Chairman Charlie Ergen told analysts "we're not acting like a mature company, all our trend lines are up."[23]

As we urged the Commission a year ago, and the intervening year only reinforces, the time has come to acknowledge unreservedly that consumers nationwide have the choice between two industries that are competing vigorously in video programming and bundled services.

D. Broadband Overbuilders and Utilities Are Competing With Cable By Concentrating Primarily On the Most Densely Populated, Most Lucrative Areas

As the two major DBS companies, DirecTV and Echostar, compete aggressively with cable systems across the nation, alternative wireline competitors are making inroads in the video marketplace. The convergence of voice, video and data services over a single broadband facility has propelled new facilities-based providers to enter the marketplace in record numbers. And, as reported last year, wireline companies are teaming up with wireless or satellite providers to provide bundled voice, video and data services. The potential efficiencies from offering telephone, high-speed Internet and an array of video programming channels over one facility provides new incentives for local facilities-based competition from new overbuilders in the core video space.

Last year, RCN, Knology, WideOpenWest, Digital Access, Inc., Carolina Broadband, Everest Connection, Grande Communications and Western Integrated Networks arrived on the scene with ambitious overbuilding plans for major cities and communities across the country. Despite recent obstacles in the capital markets arising from the economic slowdown, these

[23] "Dish Pays for its Big Sub Gains", Multichannel News, March 19, 2001.

companies have raised billions of dollars to construct alternative broadband facilities in numerous communities. Instead of spreading out around the country, the overbuilders have focussed this past year has been on targeting their financial resources in areas already under construction or rebuilding existing facilities.

In May 2001, WideOpenWest (WOW), for example, announced that it is acquiring Ameritech's cable franchises serving customers in Illinois, Michigan and Ohio for $300 million.[24] With this purchase, WideOpenWest became the 11th largest multiple system operator and will use the roughly $150 million in revenues from the Ameritech systems to help finance its planned overbuilds.[25] It has already initiated service in Denver and now has franchises to overbuild cable operators in Dallas-Ft Worth, St. Louis, and Tucson, Arizona. WOW President Mark Haverkate said he plans to "use this solid foundation as a base to launch new digital video services, and high speed Internet services in competition with incumbent providers."[26] Although expansion has slowed, WOW's rollout of Internet services continues to be a "priority."[27] It hopes to begin offering high-speed Internet services early in 2002 in 24 Ameritech New Media systems.[28]

Another major player, RCN, is targeting high growth areas, populated with residents eager for high speed Internet service. RCN's recent strategy is to focus on seven of the ten most dense and lucrative areas in the nation, including Boston, Chicago, Los Angeles, New York, San Francisco, Washington, D. C. and the Philadelphia suburbs.[29] According to an RCN spokesman,

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[24] "WideOpenWest to Acquire Ameritech's Cable TV Unit", Press Release, May 24, 2001; "SBC Sells Americast Cable Overbuild Systems to Wide Open West", Communications Daily, May 25, 2001.

[25] Id.

[26] "SBC Sells Americast Cable Overbuild Systems to Wide Open West", Communications Daily, May 25, 2001.

[27] "Chicago Overbuild Prospects Looking Up", Multichannel News, June 18, 2001.

[28] "Chicago Suburbs Weigh Cable Overbuilds", Multichannel News, July 9, 2001.

[29] "RCN Tests Home Fiber, Awaits Financial Model", Multichannel News, June 18, 2001.

the company views Chicago with its "density, Internet usage and cable penetration" as having "all the things that make a market attractive."[30] RCN has launched a package called Resilink which incorporates local telephone, high-speed Internet and cable television services in 19 towns and communities in Massachusetts and Chevy Chase, Maryland (and began offering the service in the Mission District of San Francisco in July 2001).[31] RCN's first quarter 2001 results indicate increases in connections and a 10.2% increase in revenue over 4th quarter 2000.

Western Integrated Networks (WIN) is overbuilding the AT&T Broadband system in Sacramento, CA and it recently received the go-ahead from the Los Angeles City Council to build a fiber optic network that will provide 1.4 million homes with bundled communications services.[32] WIN is obtaining approvals to become a full service provider in Seattle; Portland, Oregon; San Francisco; Oakland; Las Vegas; Phoenix; San Antonio; Austin; Dallas; and Houston. In an effort to provide an infinite number of channels and higher data speeds, RCN and WIN are pursuing a fiber-to-the-home strategy if economically feasible.[33]

Altrio Communications, which has $125 million from its first round of financing, is another full service broadband provider that is seeking to serve Los Angeles and surrounding southern California communities.[34] Altrio plans to build a network that will serve approximately 600,000 subscribers over the next several years.

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[30] "Chicago Overbuild Prospects Looking Up", Multichannel News, June 18, 2001.

[31] RCN Press Release, "RCN launches service in two new markets for Resilink, its unique bundled communications product, July 16, 2001.

[32] "Betting on Cable Payoffs", Los Angeles Times, July 27, 2001.

[33] "RCN Tests Home Fiber, Awaits Financial Model", Multichannel News, June 18, 2001. Three Chicago suburbs are reportedly considering constructing an overbuild of AT&T Broadband. "Chicago Suburbs Weigh Cable Overbuilds", Multichannel News, July 9, 2001.

[34] "Net Firms Still Gain As Venture Investing Drops Funding", Los Angeles Times, February 5, 2001.

Grande Communications, a Texas-based company with franchises in more than 25 Texas cities, has launched service in Austin, San Marcos and San Antonio and will lease 85% of its backbone facilities to other companies.[35] Knology, which serves communities in the Southeastern United States, posted strong subscriber gains and revenue growth in the first quarter of 2001.[36]

With the advent of deregulation and competition, utility companies, like other telecommunications companies, have incentives to offer new and bundled services over their facilities. Utilities, such as Sigecom in Indiana and Seren Innovations in California, are joining the new class of broadband overbuilders in offering multichannel video programming and data offerings to consumers. Seren, for example, offers its Astound-brand service in areas of St. Cloud, Minnesota and is also building a system in Contra Costa County, California.[37]

As the competitive provision of full-service voice, video and data packages spreads, the incumbent local exchange carriers – which still serve 94% of the nation's residential and business phone customers – continue to explore ways to add video programming to their product offerings. Despite some limitations with their narrowband technology already in place, their dominance in the provision of local telephone service gives them huge marketing advantages in offering bundled services.

As reported in past Annual Reports, Verizon and SBC compete with cable by offering DirecTV's DBS service packaged with telephone and data services.[38] Apart from reselling

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[35] "Despite Some Losses, Overbuilds Persist", Multichannel News, June 11, 2001.

[36] Knology Press Release, May 9, 2001. Knology completed a $93.5 million private placement in January 2001 and $5.7 million and $7.9 million private placement transactions in March and April of this year.

[37] See www.seren.com/news; "Despite Some Losses, Overbuilds Persist", Multichannel News, June 11. 2001.

[38] See e.g. Annual Assessment of the Status of competition in the Market for the Delivery of Video Programming, Seventh Report, §§120, 129.

DirecTV satellite service, "increasingly [telephone companies] have looked for ways to offer video on demand and other subscription services that can earn them a new role in the entertainment subscriptions world."[39] SBC "is laying the groundwork for a much more prominent role in a world of video on demand, music services and online gaming" through its Project Pronto, a $6 billion network upgrade to increase DSL speed to at least 1.5 Mbps by the end of 2003.[40] It intends to install new software next year that will enable customers to receive broadband services.

Qwest Communications this year introduced a means of delivering digital video programming over existing fiber optic and residential copper-wire telephone facilities to telephone subscribers in the metropolitan Phoenix area. The new technology – VDSL (very high-speed digital subscriber line) – is similar to the DSL service used by the telephone companies to provide high speed Internet service.[41] Other telephone companies are looking at VDSL as a means to compete with cable in the video business. Early trials suggest that the television service using VDSL technology is virtually indistinguishable from cable.

BellSouth has shifted its focus from wireless video operations to using its advanced wireline fiber optic network for the provision of video entertainment. Pursuant to an agreement with Echostar to sell its DBS program packages, BellSouth is converting its wireless customers to DISH Network. BellSouth has begun offering video services in competition with cable operators in several South Florida communities and is seeking franchises to expand its service in

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[39] "SBC readies new role in broadband content", CNET News.com, July 2, 2001.

[40] Id.

[41] "Qwest Puts Digital TV Over Phone Lines", The Arizona Republic, June 12, 2001.

other parts of the state. It is using a combination of direct mail and telemarketing to attract potential customers.

Cincinnati Bell announced that that it will use its high-speed broadband provider, ZoomTown.com, to deploy video-on-demand throughout its 40,000-subscriber system in the greater Cincinnati area.[42] Qwest is utilizing broadband provider Intertainer to roll out video-on-demand in Seattle, Denver, Phoenix and Portland, Oregon.

II. CABLE OPERATORS ARE UPGRADING THEIR SYSTEMS AND EXPANDING AND IMPROVING THEIR VIDEO PROGRAMMING AND OTHER SERVICES IN ORDER TO COMPETE WITH ALTERNATIVE VIDEO AND BROADBAND PROVIDERS

The rapid growth of DBS and the emergence of new alternatives to cable provide compelling evidence of competition in the video marketplace. But so does cable's competitive response to the changing video landscape. Over the last seven years, there has been steady and dramatic growth in the cable industry's spending on construction of new plant, upgrades, rebuilds, new equipment and other capital expenditures. Between 1996 – the year Congress, in the Telecom Act, overturned regulatory barriers to competition – and 2001, the cable industry has spent nearly $50 billion dollars on infrastructure upgrades. Infrastructure upgrades and facility improvements reached $12.3 billion in 2000 alone.

This year is no different. Based on projections by an industry analyst, investment is expected to reach over $12 billion by the end of 2001.[43]

[42] "VOD on DSL", Broadcasting & Cable, April 2, 2001; "Telcos Step Up VOD Pace", Cable World, April 2, 2001.

[43] "Cable Construction study through 2002", CED Magazine, May 30, 2001.

Analysts have proclaimed cable's "massive network overhauls," "big capital spending push" and increased discipline in the face of increased competition.[44] Others have touted the major MSO's "ambitious new products and services" and "swift digital roll-out."[45] By transitioning from an analog service to a combined analog and digital distribution system, cable is meeting the competition from DBS, wireless, telephone and broadband providers. The additional bandwidth created enables the delivery of high quality digital programming, including a multiplicity of new niche programming, premium and pay-per-view channels that compare favorably with the DBS program line-up, which typically offers over 100 channels.

A. Digital Cable, High Speed Internet and Cable Telephony

The unabated upgrading of cable infrastructure to fiber optics and hybrid fiber-coax architecture facilitates a broad range of video, voice and high-speed data possibilities, as well as improved signal reliability, improved pictures and two-way transmission capability. The rapid deployment of digital set top equipment also has enabled cable operators to compete more effectively with DBS by offering digital programming tiers. By the end of June 2001, an estimated 12 million homes subscribed to a cable digital service. The number of digital service customers is expected to grow to 48.2 million homes by 2005.[46] According to a recent study by the Strategis Group, digital cable subscriptions are forecast to grow to almost 50 million by 2006, a steady annual growth rate of 32%, and accounting for 67% of cable subscribers by the end of that year.[47] Paul Kagan Associates anticipates that 25 million homes will have digital boxes by

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[44] "Cable: Wired for Growth", BusinessWeek Online, March 20, 2001.

[45] "Smooth Operators Upgrading Cable's Big Seven", MediaWeekOnline, June 14, 2001.

[46] Paul Kagan Associates. Inc. Broadband Technology, Feb. 21, 2001, p.1.

[47] "The Future Looks Bright for Digital Cable, Says the Strategis Group; Strong Projected Growth Will Put DBS on the Defensive", Nexis.com, May 17, 2001.

year-end and 33 million by the end of 2002. Video-on-demand, personal video recorders (PVRs) and other advanced services are expected to persuade customers to upgrade to digital.

The cable industry now passes more than 60 million households with its high speed Internet service, and the industry's deployment of that service continues at a rapid pace. Currently, cable operators serve more than 5 million U. S. households with high-speed service, and that number could reach 7.2 million by year-end.[48] According to a recent Morgan Stanley Dean Witter consumer broadband analysis, 81 million households, or 77% of total U.S. households, will have cable modem service available by the end of 2001. That same report found that 51 million, or 49% of U.S. households, will also have DSL service available by the end of this year. And at the end of 2004, Morgan Stanley Dean Witter projects that homes passed by cable modem service and DSL will increase to 92% and 80%, respectively, of U.S. households. Cable operators also continue to develop new on-line services to take advantage of high-speed capability, such as Excite@Home, Road Runner, Optimum Online, Powerlink and Charter Pipeline.[49]

Local cable telephony is emerging as well. With upgraded digital broadband facilities, cable operators are well-positioned to offer facilities-based competition to local telephone companies. While cable telephony is a relatively new business, cable companies are now serving

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[48] Paul Kagan Associates, Broadband Technology, April 17, 2001.

[49] The cable industry competes with companies, such as Sprint and Worldcom, offering high-speed Internet access via fixed wireless. Both multichannel and multipoint distribution service aimed at residential customers and local multipoint distribution service offered to the business segment were initiated in late 2000 in a dozen major markets.

approximately 1.3 million residential phone customers using the same wires that carry cable video and Internet traffic, and this number is growing by over 70,000 customers a month.[50]

Using digital circuit-switched technology, these cable facilities compete with the existing facilities of incumbent telephone companies, typically offering savings of 10%-20% or up to 50% or more. Cable operators also are field testing Voice Over Internet Protocol telephony as the logical next step in local telephone competition. As described in a recent paper prepared by NCTA, virtually every major cable company – e.g. Charter, Comcast, Cox, AOL Time Warner – is planning to test, or is currently testing, VoIP telephony seeking lower costs, increased flexibility, and more innovative advanced services.[51]

As noted above, cable operators are exploring and beginning to test new services in the nascent interactive and on-demand spaces.[52] Charter has video-on-demand launches underway in six of the areas it serves – the Pasadena and Long Beach areas of Los Angeles, California; Gwinnett Georgia (suburb of Atlanta); Fort Worth, TX; Greenville-Spartanburg, South Carolina; Hickory, North Carolina; and Slidell, Louisiana using DIVA technology. Charter plans to introduce video-on-demand in several other areas by the end of 2001, with 2.2 million homes (22%) of its customers having access to the service.[53] Comcast is conducting VOD trials in Philadelphia and northeastern New Jersey with regular service to begin in August 2001. Similarly, Time Warner Cable is testing VOD service in Hawaii and in Columbia, South

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[50] See Appendix A, NCTA White Paper, "Cable Telephony: Offering Consumers Competitive Choice", July 2001, for a fuller discussion of cable companies use of their broadband infrastructure to provide facilities-based telephone service to both residential and business customers.

[51] Id. at 5.

[52] See e.g. Nondiscrimination in the Distribution of Interactive Television Services Over Cable, CS Docket No. 01-7, NCTA Comments and Reply Comments, March 19, 2001 and May 11, 2001, respectively.

[53] See e.g. "Charter, DIVA Expand Agreement to Deliver Video on Demand to a Total of 1.7 Million Customers", Press Release, July 18, 2001; "Consumers still wait for video-on-demand", USA Today, June 18, 2001.

Carolina and several other communities. It recently launched iCONTROL, a video-on-demand interactive service to digital cable subscribers in Austin, Texas.[54] Insight provides VOD services in its Midwest cable systems, including Rockford, Illinois; Columbus, Ohio; and Evansville, Indiana.[55]

B. Programming Investment

The cable industry's investments in programming have accelerated year after year – reaching nearly $8.9 billion in 2000 and well over $9 billion is expected to be spent in 2001.[56] Already a leader in children's and family-oriented programming, cable's investment has led to improved, original and more diverse programming choices which have drawn more viewers to cable networks.[57] And it has resulted in the creation of more new cable networks, from 82 networks in 1991 to 231 networks in 2001, a 182% increase over 10 years. At the same time that cable is expanding its services, vertical integration in the cable industry has declined from 53 percent in 1989 to 35 percent in 2000. This percentage will drop even further when AT&T completes its plans to divest Liberty Media effective August 10, 2001.

At the same time vertical integration in the cable programming industry is declining, the major commercial television broadcast networks (ABC, NBC, CBS and Fox) have increased their ownership stake in cable networks. Each of these broadcast networks today is owned by a

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[54] "Time Warner Cable launches video-on-demand movie service in its Austin system", ITV Report, June 14, 2001.

[55] "Insight and DIVA Partner to Bring Video-On-Demand to Remainder of Insight Midwest Footprint", Press Release, February 14, 2001.

[56] NCTA Estimate based on Paul Kagan Associates, Inc. and U.S. Copyright Office data.

[57] Basic cable finished the television season with its highest-ever primetime viewership –25.5 rating and 41.7 share – for the critical eight-month period when broadcast networks air the bulk of their original programming. CAB Press Release, "Primetime Viewership of Ad-Supported Cable Climbs to Record Levels for Just-Completed Official 2000/2001 TV Season," May 30, 2001.

global media company (Disney, General Electric, Viacom and News Corporation respectively) that has financial interests in a total of 79 national and regional cable networks.[58]

This year the Commission asks for information about local and regional cable channels. And cable has an important story to tell. In addition to public, educational and governmental access channels required by local franchises, cable operators are increasingly providing a broad array of local and regional news, sports, weather and original programs. In recent years, for example, 24-hour local and regional cable news channels have proliferated around the country, such as R News of Rochester (Rochester, NY and western Finger Lakes), Arizona News Channel (Phoenix, AZ area), News Channel 8 (Washington, D.C. area) and New England Cable News.[59] Central Florida News 13 (Orlando, FL), a 50/50 partnership between Time Warner Cable and the Orlando Sentinel newspaper, delivers continuous half-hour newscasts 24-hour a day. Cablevision's MetroChannels (New York, Connecticut, New Jersey) provide a suite of channels dedicated to a wide range of so-called "hyper-local" or county-by-county news, lifestyle and entertainment information.[60]

Cable also is a leading source of political and public affairs programming at the federal, state, and particularly local level. As broadcast networks cut back their public affairs and election coverage, national cable networks, such as C-SPAN, CNN and MSNBC, stepped in to offer complete primary, convention, and election reporting. Local cable news channels, such as

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[58] Disney has just announced that it will expand its cable network holdings by acquiring Fox Family Worldwide, to be renamed ABC Family, for $3 billion plus assumed debt. "Disney to buy Fox Family", Los Angeles Times, July 24, 2001.

[59] The economics of providing 24-hour/day local news are challenging. Adelphia announced this week that it was closing Orange County News Channel in Orange County, California. "Adelphia to Shut Down OCN", MultiChannel News, July 31, 2001.

[60] See Appendix B for a more complete list of local and regional services.

News Channel 8, Cablevision's News 12 channels (New York City metro area), Pennsylvania Cable Network, The California Channel, Bay News 9 (Tampa Bay metro area) and CN8 (Philadelphia metro area) offer a purely local or regional perspective. (Some of these channels are partnerships with local broadcast stations or newspapers, and News Channel 8 has no cable ownership.)

C. Digital Programming Tiers

The Commission asks in particular what services are available on digital cable tiers. These tiers, which were made possible by digital compression technology, are comprised of established program networks, new program networks spun off from a parent analog channel, and entirely new services. Some cable operators receive these digital programming services from AT&T's National Digital Television Center via Headend in the Sky (HITS), while others receive programs directly from programmer uplinks. HITS consumers can choose from 12 separate digital tiers that offer up to 155 digital networks.

The over-60 new digital channels include the Biography Channel and History Channel International (from A&E); Science, Civilization and Kids Channels (from Discovery); and Noggin, a commercial-free network launched by Nickelodeon in partnership with the Children's Television Workshop. There also are six new Hispanic channels from Liberty Canales, and a variety of channels targeting Indian, Italian, Arabic, Filipino, French, South Asian and Chinese viewers from the International Channel. Digital cable also includes an assortment of new music channels, multiplexed premium services, such as HBO Family and Showtime Extreme, and theme-based services from Starz Encore, such as Mystery and Westerns. Digital cable also offers pay-per-view movies and special events. Digital cable tiers provide the first outlet for some of these new channels.

With increased penetration of digital set top equipment, new digital programming services are seeing strong growth. The history of cable television has shown that as program networks grow they acquire and develop more and more original programming to attract their audiences. For example, the History Channel International, launched in the 1998, "is just getting to the point where it is acquiring programming exclusive to the channel in the United States, generally tapping foreign networks."[61]

The Commission suggests that some of these networks are merely "clones" of their parent or related analog channels. While some networks have "re-purposed" programming from other networks – a common practice in television – they generally also provide some original, never before seen programming. And as these networks grow in revenue and subscribership, as with any program service, they will likely develop more unique, specialized and in-depth programming to suit their particular audience.

D. <u>Technical Advances</u>

The Commission asks a series of questions about system upgrades, digital compression technology and cable channel capacity. It also asks about the status of compatibility between cable and consumer electronics equipment and CableLabs' OpenCable initiative.

As discussed above, cable companies have spent billions of dollars upgrading and rebuilding their systems for the provision of advanced video and non-video services. As of year-end 2000, approximately 62 percent of cable customers were served by systems with 54 or more channels.[62] By the end of this year, it is estimated that approximately 77 percent of cable plant

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[61] Notice at ¶55.

[62] NCTA, Cable TV Developments 2001 at 13 (Warren Communications News, Inc., Television and Cable Factbook, Volume 69, 2001).

will be upgraded to 550 MHz and above.[63] A majority of those systems have been upgraded to 750 MHz capacity or higher.[64] Even as systems are upgraded, competing demands for available capacity mean that channel space is in short supply. Digital video, in particular, outpaces increases in channel capacity as the number of national cable program networks has experienced a near three-fold increase in ten years (from 79 in 1990 to 231 in 2001).

As the competitive pressure to offer full service packages increases, cable operators will use newly constructed digital spectrum for a range of other services, including high definition programming, high speed Internet access, pay-per-view, video-on-demand and near video-on-demand, telephony, digital audio, and interactive television. Internet protocol (IP) telephony, home networking and other services under development also will be competing for limited bandwidth.[65]

The issue of compatibility between cable systems and consumer electronics equipment and CableLabs OpenCable initiative for digital equipment is the subject of an on-going Commission proceeding on compatibility and a related proceeding on the commercial availability of navigation devices.[66] This matter involves, among other things, a series of technical agreements between the two industries concerning direct connection of digital receivers to digital cable systems and the development of specifications for DTV receivers and related equipment.

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[63] NCTA, Cable & Telecommunications Industry Overview 2001 (based on Paul Kagan Associates estimates).

[64] Paul Kagan estimates for 2001 that 68 percent of cable homes will be passed by systems with 750 MHz capacity or more. NCTA, Cable & Telecommunications Industry Overview 2001.

[65] For a more detailed discussion of cable channel capacity, NCTA refers the Commission to NCTA's comments in the Further Notice of Proposed Rulemaking in the digital must carry proceeding, Carriage of Digital Television Broadcast Signals, CS Docket No. 98-120, filed June 11, 2001, and the submissions of various cable companies in response to the FCC's related channel capacity survey.

[66] Compatibility Between Cable Systems and Consumer Electronics Equipment, PP Docket No. 00-67, NCTA Progress Report, April 30, 2001; Implementation of Section 304 of the Telecommunications Act of 1996, Commercial Availability of Navigation Devices, CS Docket No. 97-80, NCTA Comments and Reply Comments, November 15, 2000 and December 18, 2000, respectively.

The cable industry and CableLabs are working jointly to develop specifications that will foster the compatibility between cable systems and consumer electronics products and which will permit consumers to receive and use all of the features and services offered by their cable operator. A full presentation on the status of compatibility and the cable industry's position is set forth in the industry's six-month status reports, progress reports and comments and reply comments in the foregoing proceedings.

III. THE CONCLUSION THAT THE VIDEO PROGRAMMING BUSINESS IS VIBRANTLY COMPETITIVE IS SUPPORTED BY THE FACTS AND OVERALL TRENDS AND IS CONSISTENT WITH ECONOMIC THEORY

In past reports, the Commission acknowledged the virtual removal of perceived barriers to DBS' growth – most of which were regulatory – and other earmarks of competition. But it nevertheless suggested that because cable's share of subscribers remained relatively high, the marketplace might not yet have become fully competitive.[67] But this interpretation of cable's percentage of the MVPD subscribers misses a critical fact. The new competitor, DBS, has national scale and has the capacity to add new subscribers throughout the nation at virtually no marginal cost. In these circumstances, the presence of this good substitute is likely to constrain any conceivable exercise of market power without regard to the percentage of subscribers still served by the incumbent. Indeed, that percentage may remain high only because the incumbent is responding to its new competitor in an effective, competitive manner.

As Economists Incorporated explained in a paper that NCTA submitted with its comments in this proceeding in 1999, "while a firm's market share can, under some circumstances, be used to infer its ability to exercise market power, it is not true that a large

[67] Comments of NCTA, CS Docket 99-230, August 6, 1999, Economists Incorporated, Inc., Use and Limitations of Structural Indicia of Market Power, attached hereto as Appendix C.

market share necessarily enables a firm to exercise market power."[68] Market shares generally reflect the relative success of market participants in the past.[69] Market power, in contrast, is "a function of how consumers and alternative suppliers would respond in the future in the event that a firm tries to raise prices above competitive levels."

Relying solely on market shares to measure market power, therefore, "may provide misleading answers to the economic questions raised."[70] As Economists Inc. pointed out, antitrust agencies, even when they are evaluating proposed mergers that would increase market shares, typically consider factors other than market share that might be relevant to the exercise of market power. These factors include non-structural indicators, such as the ubiquitous presence of a good substitute. Indeed, with respect to the video marketplace, a key factor that suggests the absence of significant market power despite cable's relatively high share of MVPD subscribership is, as EI explains, that "there is virtually no limit to the capacity of DBS providers to expand the number of customers they serve." Economists Inc. went on to say:

> DBS providers can expand output almost instantaneously because they already have invested in 100 percent national coverage [and] even at expanded service levels, the marginal cost of serving each DBS customers remains very low. For these reasons, the supply elasticity of DBS providers is likely sufficient to constrain any attempt to increase cable rates or otherwise exercise market power.

In just the two years since this analysis was provided to the Commission, developments in the marketplace seem to confirm this theory. Since 1999, cable has lost roughly six percent of all MVPD subscribers to DBS. Meanwhile, as the BLS report described supra, cable rate index

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68 Id. at 2.

69 This does not necessarily mean that cable operators had market power – because an analysis of shares of MVPD subscribers ignores any constraining effects that other sources of video programming (such as broadcasters and video stores), as well as other sources of entertainment, may have had on the price and competitive behavior of cable operators.

70 Id at 5.

increases have been sharply curtailed, and cable's investment in efforts to retain and win back subscribers through dish buybacks and other incentives has been prodigious.[71]

There is no doubt that DBS is comparable to cable in terms of content and price and is a readily substitutable product for cable. DBS and other competitors now have nearly 23 percent of the multichannel video customers, as cable's share continues to decline. Consumers can switch between services with ease. The fact that many customers stay with their cable operator or switch back to cable from other providers indicates not that cable is significant market power but that it is responding to its competition by providing a better product and better service.

The Commission should find, in its Eighth Annual Report, that this is the case.

IV. THE PROGRAM ACCESS RULES NEED NO FURTHER MODIFICATIONS BEFORE BEING ALLOWED TO SUNSET IN 2002

The Commission has again raised questions about the effectiveness of its now seven-year old "program access" rules. Pursuant to the 1992 Cable Act, the program access rules limit the extent to which satellite-delivered cable programmers that are owned, in whole or in part, by a cable operator may enter into exclusive agreements with cable operators or may discriminate in the price, terms and conditions of the sale of its programming to competing MVPDs.[72] The limitations on exclusivity will sunset on October 5, 2002 unless the Commission determines, in a proceeding to be conducted this year, that they remain "necessary to preserve and protect competition and diversity in the distribution of video programming."[73]

The Commission asks whether the "coverage of the program access rules is appropriate." In light of the well-documented success and continued growth of DBS and the emergence of

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71 "DBS 'Win-Backs' Are Winning Over Ops", Multichannel News, July 30, 2001.

72 The Cable Television Consumer Protection and Competition Act of 1992, P.L. No. 102-385, 106 Stat. 1460.

73 47 U.S.C. § 548(c)(5).

multiple new competitive providers of video programming, the program access rules have accomplished what Congress intended and should not be expanded.

The purpose of the program access requirements is to ensure that consumers have a choice of providers of video programming, and that cable operators not impede competition from developing by denying potential competitors access to core satellite-delivered programming owned by cable companies. In 1992, DBS was still on the horizon but not yet launched and telephone companies were still barred by law from providing video programming to subscribers in their telephone service areas. The competitive facilities-based providers we have today were unknown; and digital technology, which enabled video, voice and data over the same wire, was barely anticipated.

In an effort to jump-start competition to cable from new providers, Congress looked to program access regulation. Congress understood, however, that there were legitimate, pro-competitive reasons for programmers to enter into exclusive contracts with particular distributors or to negotiate different rates, terms and conditions with different distributors. And it recognized that in a competitive environment, the development or acquisition of exclusive programming by cable operators and other distributors could be a legitimate means of competition that would ultimately *increase* the programming options available to consumers. That is why it limited the program access restrictions to programming and practices that were deemed likely to prevent entirely the emergence of competitive providers:

> There is an argument against our amendment someone made. The argument is that we no longer allow for exclusive type programs that are important to people who develop a product. Not so. . . . [O]ur amendment says that exclusive programming that is not designed to *kill the competition* is still permitted. The FCC can grant exclusive programming rights under our amendment.[74]

[74] Id. at 6534 (emphasis added).

Thus, Congress limited the restrictions by authorizing the Commission to permit even vertically integrated, satellite-delivered program networks to enter into exclusive agreements or contracts with different prices, terms and conditions under certain circumstances where such practices were more likely to be pro-competitive than to be aimed at preventing the emergence of competition.[75]

The video marketplace that the program access rules exist in today is undoubtedly far different from the competitive video landscape that existed in 1992. As we showed in the preceding sections, two DBS providers exceed the size of most MSO's and wield significant clout in the competition for subscribers. And each of them has developed or acquired certain exclusive programming that permits them to differentiate themselves competitively to the benefit of consumers. Moreover, other well-financed competitors are emerging to overbuild incumbent cable operators.

As competition has grown, so have the programming options for consumers. Today, there are more than 200 program networks competing for viewers, most of which are not vertically-owned or affiliated with a cable company. Some programming may be acquired on an exclusive basis – by cable operators *or* by alternative providers such as DBS – as a means of differentiating their product and attracting subscribers. As discussed earlier, DBS has for several years had exclusive rights to some major league sports packages, as well as concerts, and other programming. Similarly, some cable operators have developed or encouraged the development of cable-exclusive terrestrially-delivered local or regional programming as a means of

[75] See 47 U.S.C. § 548(c)(2)(B) and (c)(4).

differentiating themselves from their competitors. But there is more than enough programming competing for viewership to ensure that cable's competitors will not fail for lack of available programming. And the exclusive programming that has been developed for cable operators or for DBS or other competitors expands the range of programming options available to consumers.

In this environment, extending the coverage or broadening the scope of program access regulation to cover terrestrially-delivered or non-vertically integrated programming is entirely unwarranted. Moreover, if the competition that has developed in the past five years shows that the exclusivity prohibition for which Congress provided in Section 628(c)(5) should sunset.

CONCLUSION

Consumers can choose today from a range of competitive providers of video programming. The marketplace is still evolving, still unsettled in many ways, but the convergence of video, voice, and data services in the digital broadband marketplace will only reinforce the permanence of competition in the marketplace. In this competitive environment, cable, DBS, telephone companies, and other players compete every month for the subscriber's loyalty. And consumers will continue to be the beneficiaries as the array of services and competitors continue to grow.

Respectfully submitted,

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Appendix A