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 Markets for the	)	
Delivery of Video Programming	)	

REPLY COMMENTS OF AT&T CORP.

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AT&T Corp. ("AT&T") hereby files its reply comments in response to the Commission's Notice of Inquiry ("*Notice*") in the above-captioned proceeding.[1] AT&T's reply briefly focuses on three issues raised in the comments: the current state of video competition in the MVPD marketplace; cluster pricing and service issues; and EchoStar's unfounded criticism of AT&T's packaged service offerings.

1. Video Competition

Competing video service providers continue to assert that the MVPD marketplace is dominated by the cable industry.[2] However, there are two significant flaws with this view. First, it fails to acknowledge the significant changes that have occurred in the MVPD marketplace over the last several years -- changes that effectively eliminate the ability of *any* MVPD to dominate the marketplace. Second, it is based on the overly simplistic notion that market share alone is

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[1] *In the Matter of Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming*, Notice of Inquiry, CS Docket No. 01-129, FCC 01-191 (rel. June 25, 2001) ("*Notice*").

[2] *See, e.g.*, EchoStar Comments at 5; WCA Comments at 3-4; NAB Comments at 8.

sufficient to establish market power. In fact, any analysis of competition must consider a variety of complex factors, and when these factors are taken into account, it is clear that cable operators do not have market power.

Certain commenters wrongly portray the MVPD marketplace as essentially unchanged since the mid-1990s when DBS was still a relatively small industry.[3] As NCTA, AT&T, and Comcast noted, non-cable MVPDs now account for over 23% of multichannel video customers nationwide, up from 20% a year ago, and DirecTV and EchoStar are now the third and seventh largest MVPDs, respectively.[4] Even the satellite industry acknowledges the substantial growth of non-cable MVPDs. For example, according to SBCA, direct-to-home penetration rates now exceed 10% in 45 states (up from 44 states a year ago); 20% in 30 states (up from 24 states last year); 30% in 5 states (compared to 3 states a year ago); and 40% in 1 state (compared to none previously).[5] SBCA also emphasized that the average growth rate for a satellite MVPD over the last year was 24.86% -- compared to a 1.2% growth rate for cable -- and that DBS is signing up 8,500 customers every day.[6] Moreover, as AT&T pointed out, most industry analysts agree that DBS will continue to experience substantial growth.[7]

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[3] *See, e.g.*, EchoStar Comments at 5; RCN Comments at 6.

[4] *See* NCTA Comments at 7-8; AT&T Comments at 5; Comcast Comments at 3.

[5] *See* SBCA Comments at 4 (Table 2). Other non-cable competitors are also growing. *See, e.g.*, RCN Comments at 5-6 (noting that RCN has enjoyed "substantial growth in the Boston, New York, Philadelphia, Washington, D.C., Chicago, Los Angeles and San Francisco venues").

[6] *See* SBCA Comments at 3-5; *Kagan Media Money*, June 26, 2001, at 11. *See also* AT&T Comments at 5-6 (noting that DirecTV added 175,000 net subscribers and EchoStar added 350,000 net subscribers in the second quarter of this year).

[7] *See* AT&T Comments at 5-6 (noting that DBS providers are expected to add another 3 million subscribers next year, bringing their total to 19 million, and will eventually grow to 25 million by the end of 2005 and 27 million by 2008).

Indeed, given DBS' extensive program offerings, including local broadcast signals,[8] it is not surprising that the satellite industry's own data demonstrate that DBS is a substitute for cable. DirecTV, for example, stated in its comments that "roughly half of DirecTV customers were cable subscribers at the time they first subscribed to DirecTV" and that of these customers "the majority cancelled their cable subscription once they activated DirecTV."[9]

Thus, even on the basis of market share data alone, it is clear that the ubiquitous and increasingly powerful marketplace presence of DBS in particular substantially restrains cable operators' ability to act in an anticompetitive manner. Moreover, the Commission and the courts have recognized that market share is only the *beginning* of the analysis as to whether a particular competitor has market power.[10] Under a dynamic analysis that accounts for *all* relevant criteria, the evidence is even more compelling that the growing strength of DBS and other competitors constrains cable operators from exercising market power.

While market share is generally a measure of how successful a firm has been in the *recent past*, market power reflects how consumers and alternative suppliers would respond *in the*

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8 *See id.* at 6-7 (noting that DirecTV now provides local signals in 43 markets, and EchoStar in 36 markets, and both providers have plans to expand this service into additional markets).

9 DirecTV Comments at 11. *See also* AT&T Comments at 6 (noting that the Commission's *2000 Price Report* found for the first time that DBS is a substitute for cable services). The satellite industry also confirms that the offering of local-into-local service as well as two-way, high-speed Internet service has been instrumental to the industry's remarkable growth. *See, e.g.*, DirecTV Comments at 12-13 (noting that DirecTV's overall subscriber levels have increased by 20% as a result of local broadcast channel service); SBCA Comments at 5 (noting that the satellite industry is gaining subscribers from new consumer technologies, including two-way, high-speed Internet service).

10 *See* AT&T Comments at 9-11 (citing Commission precedent and judicial decisions).

future should a firm try to raise prices above competitive levels.[11] In this regard, AT&T and NCTA pointed out that DBS providers have the characteristics of firms that can constrain or eliminate the market power of other firms, even those with substantial market share.[12] In particular, DBS providers have virtually unlimited capacity to rapidly increase the number of customers they serve because their networks already provide 100% national coverage. Also, the marginal cost of serving each additional DBS customer is very low. The marginal cost of using the satellite to serve another customer is zero; the marginal cost of providing customers with reception equipment is small and falling; and the cost of providing programming services to additional customers is similar to that for a cable operator. Consequently, the supply elasticity of DBS providers is sufficient to constrain any attempt by a cable operator to increase prices unreasonably or otherwise exercise market power.

Furthermore, AT&T and other commenters demonstrated that the behavior of cable operators reflects the marketplace constraints under which they operate. First, cable operators are not imposing non-cost-based price increases. As AT&T noted, the Commission has already found that cable operators' programming costs have increased dramatically, as have infrastructure expenses.[13] Yet, the per-channel price for cable has *decreased* when adjusted for

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11 Thus, as the U.S. Court of Appeals for the D.C. Circuit recently noted in its *Time Warner* decision, "a company's ability to exercise market power depends not only on its share of the market, but also on elasticities of supply and demand, which in turn are determined by the availability of competition." *Time Warner Entm't v. FCC*, 240 F.3d 1126, 1134 (D.C. Cir. 2001).

12 *See* AT&T Comments at 11-12; NCTA Comments at 34-36 & App. C.

13 *See* AT&T Comments at 12-13 (citing *2000 Video Competition Report*).

inflation from 69¢ per channel to 66¢ per channel.[14] Second, cable operators are not restricting output. As NCTA showed, cable operators are increasing the number of channels and programs available to consumers.[15] Third, cable operators are not refraining from innovation. To the contrary, cable companies have devoted billions of dollars upgrading their cable facilities to provide customers with new digital services, including digital video, cable Internet service, and telephony.[16]

In short, cable operators' continuing efforts to increase the amount and quality of video programming they offer and to provide innovative services like competitive telephony, while holding prices in line, confirm the conclusion that DBS and other MVPD providers constrain any attempt by cable operators to exercise market power.

2. Clustering

EchoStar's suggestion that clustering "has not resulted in the promised benefits to consumers" is baseless.[17] As an initial matter, EchoStar overlooks the fact that the Commission has previously acknowledged the pro-consumer benefits of clustering, as have GAO and NTIA.[18]

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14 *See id* at 13. *See also* NCTA Comments at 13-17 ("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.").

15 *See* NCTA Comments at 29-32 (describing expansion of programming services).

16 *See id* at 26-29 (noting investment in cable facilities to accommodate digital cable, cable Internet, and telephony services). *See also* AT&T Comments at 14-15 (estimating that, since 1996, AT&T's investments to upgrade its cable networks exceed $4 billion).

17 EchoStar Comments at 6.

18 *See* AT&T Comments at 16-17 (citing benefits and relevant government reports). *See also* AT&T Comments, filed in CS Dkt. No. 00-132, at 11-12 (Sept. 8, 2000) ("AT&T 2000 Video Competition Comments") (same).

Moreover, AT&T provided facts and econometric analysis as part of its comments in the *2000 Video Competition* proceeding confirming that clustering facilitated the provision of advanced services, such as local telephony and cable Internet service, and that AT&T's clustered systems provided a greater number of activated channels and a greater number of digital video services than non-clustered systems.[19]

EchoStar also ignores flaws in the Commission's methodology for analyzing the effect of clustering on cable prices. As AT&T previously indicated, there are a number of factors that could explain why the Commission's analysis yielded the results that it did.[20] Although the Commission accounted for one of these factors in its modified regression, it did not address any of the other factors AT&T identified.[21] In addition, the Commission did not respond to AT&T's concerns regarding the effects of programming costs on cable prices or take into consideration that clustering, by facilitating the offering and packaging of multiple video and non-video services, will yield lower *overall* prices for consumers that are not reflected in the Commission's analysis.[22]

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19 *See* AT&T Comments at 17-18; AT&T 2000 Video Competition Comments at 7-10.

20 *See* AT&T Comments at 18-20; AT&T 2000 Video Competition Comments at 15-16.

21 *See* AT&T Comments at 19 (noting that the Commission's modified regression did not include variables for whether the system offers local telephony or Internet access, the number of subscribers in the franchise generally, or the number of subscribers to the specific package of services and equipment whose price was being analyzed in the regression).

22 *See id.* Consequently, EchoStar is wrong in suggesting that the Commission "repeated the analysis using the method suggested by cable interests." EchoStar Comments at 7. Furthermore, EchoStar fails to note that the Commission has acknowledged that its findings might be due to factors not reflected in its analysis. *See* AT&T Comments at 19 & n.55 (citing statements in Commission's *2000 Price Report*).

At any rate, EchoStar provided no analysis or evidence of any type to support its conclusory statements on the effects of clustering. Consequently, the Commission should give no weight to those statements.

3. Packaged Service Offerings

EchoStar also alleges -- again, without support of any kind -- that AT&T would cross-subsidize its provision of cable services with revenues from long distance service.[23] EchoStar's allegation is completely unfounded and incorrect as a matter of basic economics. First, as the Commission recently concluded in its unbundling order for customer premises equipment ("CPE"), long distance carriers cannot engage in anticompetitive pricing by packaging long distance service with other services and equipment because the long distance market is competitive.[24] In such circumstances, a long distance provider's price for a package of services "would have to be cost-based or the carrier could not offer profitably such a bundled discount in the long run."[25] Second, as the Commission has also determined, rational businesses do not cross-subsidize absent a cost-based rate-of-return form of rate regulation,[26] and long distance providers are not subject to such regulation.

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23 *See* EchoStar Comments at 8-9.

24 *See In the Matter of Policy and Rules Concerning the Interstate, Interexchange Marketplace; Implementation of Section 254(g) of the Communications Act of 1934, as amended; 1998 Biennial Regulatory Review -- Review of Customer Premises Equipment And Enhanced Services Unbundling Rules In the Interexchange, Exchange Access And Local Exchange Markets*, 16 FCC Rcd. 7418, at ¶ 24 (2001) ("*CPE Unbundling Order*").

25 *Id.*

26 *See In the Matter of Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from Tele-Communications, Inc., Transferor, To AT&T Corp., Transferee*, 14 FCC Rcd. 3160, at ¶¶ 119-120 (1999) ("*AT&T-TCI Merger Order*") ("[Regulatory predation] works only if price regulation is based on a type of cost-of-service model that is not fully effective in policing the actual costs of the regulated service, such that the

(footnote continued ...)

Moreover, EchoStar's criticism of AT&T's packaged service offerings conflicts with the Commission's finding that the packaging of services can provide substantial benefits for consumers. In particular, the Commission noted in its *CPE Unbundling Order* that, among other things, "offering consumers the choice of purchasing packages of products and services at a single low rate will encourage them to subscribe to new, advanced, or specialized services by reducing the costs that they have to pay up-front to purchase equipment, or by giving them a choice of relying on one provider instead of having to assemble the desired combinations on their own."[27] Indeed, as the comments in the instant proceeding attest, consumers have expressed strong interest in packages of video and non-video services, and cable and its competitors, including EchoStar, are competing vigorously to meet that demand.[28]

(... footnote continued)

company can include improperly the costs of another service in the cost (and rates) of the regulated service.").

27 *CPE Unbundling Order* at ¶ 10. *See also id.* at ¶¶ 15-16 (detailing consumer benefits associated with bundling); *AT&T-TCI Merger Order* at ¶ 125 (same); *In the Matter of Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from MediaOne Group, Inc., Inc., Transferor, To AT&T Corp., Transferee*, 15 FCC Rcd. 9816, at ¶ 141 (2000) ("Purchasing the package of bundled services thus could be cheaper than the sum of purchasing each of the bundled services on a stand-alone basis.").

28 *See* AT&T Comments at 25-28 (noting that "EchoStar now offers a discount package that combines its 'America's Top 150' video programming service with StarBand's satellite broadband access service for $99.00 per month"); RCN Comments at 3-4 (noting bundled offerings of local and long distance telephony, high-speed Internet access, and broadband video); DirecTV Comments at 16 (noting offering of integrated satellite receiver and Internet access platforms such as DirecTV Receiver with UltimateTV). *See also Hughes Reaches Pact With Circuit City To Peddle Broadband at Retail Outlets*, Wall St. J., Aug. 29, 2001 (noting DirecTV's plans to bundle a wide array of video-entertainment, Internet, household-monitoring, and voice services through retail arrangement with Circuit City).

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For the foregoing reasons, AT&T respectfully urges the Commission to adopt a report to Congress that is consistent with the reply comments herein and with AT&T's initial comments.[29]

Respectfully submitted,

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[29] AT&T also notes that Sherjan Broadcasting ("Sherjan"), the licensee of Class A television station WJAN-CA in Miami, Florida, complains in its comments about the leased access rates charged by AT&T for carriage of the station on AT&T's cable systems in the Miami area. *See* Sherjan Comments at 3. Sherjan has filed a lawsuit against AT&T on this matter in federal court, and the issues will be addressed in that forum. While AT&T believes Sherjan's claims are without merit, AT&T wishes to point out here that the leased access rate increases referenced by Sherjan were the first such increases for most AT&T systems in five years or more and were below the maximum permitted under the Commission's leased access rules.