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

In the Matter of	)	
Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992	)	CS Docket No. 98-82
Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996	)	CS Docket No. 96-85
The Commission's Cable Horizontal and Vertical Ownership Limits and Attribution Rules	)	MM Docket No. 92-264
Review of the Commission's Regulations Governing Attribution Of Broadcast and Cable/MDS Interests	)	MM Docket No. 94-150
Review of the Commission's Regulations and Policies Affecting Investment In the Broadcast Industry	)	MM Docket No. 92-51
Reexamination of the Commission's Cross-Interest Policy	)	MM Docket No. 87-154

FURTHER NOTICE OF PROPOSED RULEMAKING

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By the Commission: Commissioner Copps issuing a statement.

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I. INTRODUCTION

1. In *Time Warner Entertainment Co. v. FCC* ("*Time Warner*"),[1] the United States Court of Appeals for the D.C. Circuit reviewed the Commission's cable television horizontal and vertical ownership limits[2] and attribution benchmarks,[3] and reversed and remanded the rules. The Commission's horizontal limit bars a cable operator from having an attributable interest in more than 30 percent of nationwide subscribership of multi-channel video programming, and the vertical limit bars a cable operator from carrying attributable programming on more than 40 percent of channels up to 75 channels of capacity. The Commission's attribution rules serve to define the level of ownership interest implicated by these limits.

2. To address the consequences of horizontal concentration and vertical integration in the cable television industry, Congress adopted Section 613(f) of the Communications Act as part of the Cable Television Consumer Protection and Competition Act of 1992 ("1992 Act").[4] This provision directs the Commission to establish limits on the number of cable subscribers that may be reached through commonly owned or attributed cable systems and to prescribe rules limiting the number of channels that can be occupied by the cable system's owned or affiliated video programming. In response to a First Amendment challenge to the constitutionality of this provision, the D.C. Circuit in *Time Warner Entertainment Co. v. United States*,[5] upheld this provision of the statute as "facially constitutional" under the "intermediate scrutiny" test,[6] finding that it fostered governmental interests in diversity and competition.[7] Subsequently, in *Time Warner,* the D.C. Circuit found that the Commission's horizontal rule restricts cable operators' ability to reach viewers and that the vertical rule curtails their exercise of

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[1] 240 F.3d 1126 (D.C. Cir. 2001).

[2] The ownership rules in question were adopted in *Implementation of Section 11(c) of the Cable Television Consumer Protection and Competition Act of 1992 Horizontal Ownership Limits,* Third Report and Order, MM Docket No. 92-264, 14 FCC Rcd 19098 (1999) ("*1999 Horizontal Order*").

[3] The attribution rules in question were adopted in *Implementation of the Cable Television Consumer Protection and Competition Act of 1992 Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996 Review of the Cable Attribution Rules*, CS Docket Nos. 98-82 and 96-85, Report and Order, 14 FCC Rcd 19014 (1999) ("*1999 Attribution Order*").

[4] Section 613(f) was adopted as Section 11(c) of the Cable Television Consumer Protection and Competition Act of 1992, Pub. L. No. 102-385, 106 Stat. 1460, codified at 47 U.S.C. § 533(f).

[5] *See Time Warner Entertainment Co., L.P. v. United States*, 211 F.3d 1313 (D.C. Cir. 2000) ("*Time Warner v. United States*").

[6] *See United States v. O'Brien,* 391 U.S. 367, 377 (1968), which established the "intermediate scrutiny" standard of review for content-neutral, but speech-restricting, regulations. Under that standard, a regulation will withstand First Amendment challenge if it advances important or substantial governmental interests and does not burden speech substantially more than necessary.

[7] The D.C. Circuit rejected arguments that the Section 613(f) horizontal and vertical limits are unnecessary in light of the antitrust laws generally and the behavioral restrictions established by the 1992 Act specifically. *Time Warner v. United States,* 211 F.3d at 1320, 1322-23. The D.C. Circuit distinguished Section 613(f) as establishing structural limits, as opposed to behavioral restrictions. *Id.* As structural limits, the D.C. Circuit found that Section 613(f) "adds a prophylaxis to the law and avoids the burden of individual proceedings to remedy particular instances of anticompetitive behavior" and thus is not rendered unnecessary by other laws that impose behavioral restrictions. *Id.*

editorial control over a portion of their channels. The D.C. Circuit held that the Commission did not establish record evidence to support the limits, did not draw the necessary connection between the limits established and the alleged harms of concentration and integration the limits were designed to address, and did not take into account the changing industry market conditions. The D.C. Circuit thus remanded both the horizontal and vertical limits to the Commission for further consideration.[8] The D.C. Circuit also found that, unlike the horizontal and vertical limits, the cable attribution benchmarks do not constrain speech, but rather affect "investments in a particular class of companies."[9] The D.C. Circuit upheld the general attribution benchmarks under administrative standards of review, but vacated several aspects of the rules as "lacking rational justification."[10] By this *Further Notice of Proposed Rulemaking* ("*Further Notice*"), we are seeking comment on the Commission's rules and policies implicated by the *Time Warner* decision.[11]

II. BACKGROUND

3. A principal objective of the 1992 Act was to foster competition in the acquisition and delivery of multi-channel video programming by encouraging the development of alternative and new technologies, including cable and non-cable systems.[12] Congress evidenced a preference for competition over regulation in order to achieve this objective, believing that the presence of alternative cable and non-cable multi-channel video programming distributors ("MVPDs")[13] would constrain cable operators' market power in the acquisition and distribution of multi-channel video programming,[14] as well as improve their service and programming quality and curb their subscription rate increases.[15] As detailed

[8] *Id.* at 1128, 1130.

[9] *Id.* at 1140.

[10] *Id.*

[11] On January 3, 2000, Consumer Federation of America, Center for Media Education, Association of Independent Video and Film Makers, Office of Communication, Inc., and United Church of Christ (collectively referred to as "CFA") petitioned the Commission to reconsider its ownership and attribution rules. In light of the *Time Warner* decision vacating these rules, we dismiss the petitions as moot. *See* ¶ 134, *infra*.

[12] *See* S. Rep. No. 92, 102d Cong., 1st Sess. 1, 18 (1991) ("*Senate Report*"); H. Rep. No. 628, 102d Cong., 2d Sess. 27 (1992) ("*House Report*"); *see also* 1992 Act §§ 2(b)(1)-(5).

[13] MVPDs include, but are not limited to, providers of cable, multi-channel multipoint distribution, direct broadcast satellite, and television receive-only program distribution services that make "available for purchase by subscribers or customers, multiple channels of video programming." 47 U.S.C. § 522(13).

[14] *See Senate Report* at 12, 18, 20-24; *House Report* at 30, 44; *see also Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, CS Docket No. 00-132, Seventh Annual Report, 16 FCC Rcd 6005, 6007 n.4 (2001) ("*Seventh Annual Report*") (the 1992 Act "imposed a regulatory scheme on the cable industry designed to serve as a transitional mechanism until competition develops and consumers have adequate multi-channel video programming alternatives"). In fact, experience has shown that competition does result in lower rates, improved service, and increased programming fare. *Id.* at 6092-98.

[15] Various provisions of the 1992 Act reflect congressional concern "about concentration of the media in the hands of a few who may control the dissemination of information" at the local, regional and national levels. *Senate Report* at 32. *See e.g.*, 47 U.S.C. § 543(b)(1) (requiring the Commission to issue rules to protect subscribers of "any cable system that is not subject to effective competition" from excessive rates); 47 U.S.C. § 541(a)(1) (prohibiting local authorities from granting exclusive franchises or unreasonably refusing to award additional franchises); 47 U.S.C. § 533(a)(2) (limiting cable operators from owning MMDS or SMATV systems within their franchise areas); 47 U.S.C. § 533(d) (allowing local authorities to deny transfers of franchises that would reduce or eliminate competition in the

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below, however, Congress found that the cable industry, the nation's dominant and increasingly horizontally concentrated medium for the delivery of multi-channel programming, faced virtually no competition at the local level, and only limited competition at the regional and national level.[16] Additionally, Congress found that the increase in vertical integration between cable operators and programmers provided incentives and opportunities for cable operators to favor affiliated over non-affiliated programmers and, likewise, for programmers to favor affiliated over non-affiliated operators in the distribution of video programming.[17] Thus, given the absence of competition at the time,[18] Congress believed that certain structural limits were necessary.[19]

4. To address the consequences of horizontal concentration and vertical integration in the cable industry, Congress adopted subscriber (horizontal) and channel occupancy (vertical) provisions in Section 613(f).[20] These provisions direct the Commission, "in order to enhance effective competition," to establish reasonable limits on the number of cable subscribers that may be reached through commonly owned or attributed cable systems, and to prescribe rules limiting the number of channels that can be occupied by the cable system's owned or affiliated video programming. Specifically, Section 613(f) provides:

> (1) In order to enhance effective competition, the Commission shall, within one year after the date of enactment of the Cable Television Consumer Protection and Competition Act of 1992, conduct a proceeding - -
>
> (A) to prescribe rules and regulations establishing reasonable limits on the number of cable subscribers a person is authorized to reach through cable systems owned by such person, or in which such person has an attributable interest; [and]
>
> (B) to prescribe rules and regulations establishing reasonable limits on the number of channels on a cable system that can be occupied by a video programmer in which a cable operator has an attributable interest.[21]

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delivery of cable services); 47 U.S.C. § 544(b)(2)(C) (requiring the Commission to issue rules that promote the commercial availability of cable consumer equipment); 47 U.S.C. § 547(b) (prohibiting cable operators from engaging in unfair practices *vis-à-vis* video programmers and other MVPDs).

[16] *See* 1992 Act §§ 2(a)(2)-(4), (6); *see also Senate Report* at 12, 13-18, 20, 32-34; *House Report* at 27, 43-47.

[17] *See Senate Report* at 24 ("when cable systems are not subject to effective competition . . . [p]rogrammers either deal with operators of such systems on their terms or face the threat of not being carried in that market. The Committee believes this disrupts the crucial relationship between the content provider and the consumer…. Moreover, these concerns are exacerbated by the increased vertical integration in the cable industry."); *see also* 1992 Act §§ 2(a)(5)-(6); *House Report* at 41.

[18] *See* n.16, *supra*.

[19] *See Senate Report* at 18, 25-26, 33; *House Report* at 26, 30, 40-44.

[20] Section 613 was adopted as Section 11(c) of the Cable Television Consumer Protection and Competition Act of 1992, Pub. L. No. 102-385, 106 Stat. 1460, codified at 47 U.S.C. § 533(f).

[21] Additionally, Section 613(f)(1), 47 U.S.C. § 533(f)(1), requires the Commission to consider whether it is necessary or appropriate to restrict MVPDs' participation in video programming development. Specifically, Section 613(f) directs the Commission:

(continued.…)

In prescribing such limits, a principal congressional objective was to prevent the dominant cable medium from stifling the video programming market, and further to encourage the development of, and competition within, the video programming market.[22] This, in turn, would help to make diverse programming available to consumers.[23] Section 613(f) requires the Commission to establish structural limits that are "reasonable"[24] and that serve the "public interest,"[25] and to identify those interests that are deemed "attributable" and thus implicated by the limits.[26] Congress also identified several factors the Commission must take into account, "among other public interest objectives," in setting the structural limits. Specifically, the Commission is directed to:

> (A) ensure that no cable operator or group of cable operators can unfairly impede, either because of the size of any individual operator or because of joint actions by a group of operators of sufficient size, the flow of video programming from the video programmer to the consumer;
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> (B) ensure that cable operators affiliated with video programmers do not favor such programmers in determining carriage on their cable systems or do not unreasonably restrict the flow of video programming of such programmers to other video distributors;
>
> (C) take particular account of the market structure, ownership patterns, and other relationships of the cable television industry, including the nature and market power of the local franchise, the joint ownership of cable systems and video programmers, and the various types of non-equity controlling interests;
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> (D) account for any efficiencies and other benefits that might be gained through increased ownership or control;

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> (C) to consider the necessity and appropriateness of imposing limitations on the degree to which multichannel video programming distributors may engage in the creation or production of video programming.

Given the 1992 Act's structural and behavioral restrictions, the Commission found that it was not necessary or appropriate to adopt such restrictions on MVPDs' development of video programming. *See Implementation of Sections 11 and 13 of the Cable Television Consumer Protection and Competition Act of 1992, Horizontal and Vertical Ownership Limits*, MM Docket No. 92-264, Second Report and Order, 8 FCC Rcd 8576 (1993)("*Second Report*"). Specifically, the Commission noted that the horizontal and vertical structural limits are "intended to promote diversity and to encourage competitive dealings between cable programming services and cable operators and between cable programming services and competing radio distributors." *Id.* at 8607. Additionally, the Commission observed that the behavioral restrictions of the 1992 Act prevent cable operators from "requiring either exclusive rights or a financial interest in programming services as a condition of carriage," "discriminating against unaffiliated programmers," and "engaging in 'unfair' and deceptive practices that would hinder competition in cable service and programming or inhibit delivery of programming to consumers." *Id.* at 8608.

[22] *See* 1992 Act §§ 2(a)(4)-(6), (b)(1)-(5); *Senate Report* at 24-27, 32-34; *House Report* at 40-44.

[23] *Id*.

[24] *Senate Report* at 80.

[25] 47 U.S.C. § 533(f)(2). Thus, in setting the subscriber and channel occupancy limits, Congress directed the Commission to consider the potential beneficial and detrimental effects of consolidation and integration in the cable industry in the context of a changing communications marketplace.

[26] *Senate Report* at 80.

(E) make such rules and regulations reflect the dynamic nature of the communications marketplace;

(F) not impose limitations which would bar cable operators from serving previously unserved rural areas; and

(G) not impose limitations which would impair the development of diverse and high quality video programming.

5. As described in *Time Warner v. United States,* which upheld the underlying statute, Congress had two principal objectives in mind in adopting Section 613(f). First, Congress was concerned about concentration of the media in the hands of a few who could control the dissemination of information which would enable cable operators to impose their own biases upon the information they disseminate.[27] Second, Congress was concerned that an increase in concentration and vertical integration in the cable industry could result in anti-competitive behavior by cable operators toward programming suppliers, as well as toward potential new entrants. The court described the concerns of Congress as "… well grounded in the evidence and a bit of economic common sense."[28] The public interest factors set forth in Section 613(f) reflect Congress' concern over the detrimental, anti-competitive effects of ownership patterns developing in the cable industry.[29] Congress believed that concentration and vertical integration would allow such firms to favor their own affiliated programming services and jeopardize the viability of independent programming services, which thereby could reduce programming diversity.[30] However, the delineated public interest factors also reflect congressional recognition of the potential beneficial effects of concentration and integration in the cable industry.[31] Congress recognized that some level of concentration and integration produces efficiencies in the administration, distribution and procurement of programming, and fosters investment in innovative and risky programming fare, which may benefit consumers in terms of lower rates, better service and more diversified programming choices.[32]

6. In considering horizontal and vertical limits for the cable industry, the Commission thus must weigh the public interest objectives, and take into account the beneficial and detrimental effects of cable concentration and integration. Additionally, the Commission must consider the evolving and "dynamic" nature of the communications marketplace,[33] as Congress recognized that alternative services and technologies are being, and will be, introduced.[34] In this regard the *Senate Report* states "[B]ecause

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[27] 211 F. 3d at 1316. However, we note that in the subsequent review of the Commission's implementation of regulations, the D.C. Circuit found that Congress' primary concern behind Section 613(f) was to promote "'fair competition'… sharply confin[ing] the [Commission's] authority to regulate solely in the interest of diversity." *Time Warner,* 240 F.3d at 1135.

[28] *Id.* at 1332.

[29] *See* 47 U.S.C. §§ 533(f)(2)(A), (B), (C).

[30] *See Senate Report* at 24-27, 32-33; *House Report* at 41.

[31] *See* 47 U.S.C. §§ 533(f)(2)(D), (F), (G).

[32] *See Senate Report* at 33-34; *House Report* at 43.

[33] 47 U.S.C. § 533(f)(2)(E).

[34] *See Senate Report* at 12, 80; *House Report* at 27.

these markets are dynamic, the FCC should revisit these limitations at appropriate times to ensure that they accurately reflect the policies of this legislation."[35] As required, the Commission adopted structural limits, as well as attribution benchmarks, and periodically revised its rules through further rulemaking proceedings.[36]

7. In accordance with our statutory mandate, First Amendment principles, and the second *Time Warner* decision, we now seek to reexamine our rules and the state of competition in the MVPD market to ensure that our rules are reasonable and serve the public interest. On remand, we recognize that the subscriber ownership and channel occupancy limits that we implement must reflect the MVPD industry's market conditions. It is primarily within that framework that we are soliciting comment on the horizontal and vertical ownership limits.[37] Specifically, we seek theoretical justification and empirical evidence of alleged harms of concentration. We also seek comment on market conditions and changes that have taken place since the 1992 Act. We believe this input will allow us to draw a closer tie between the possible harms of concentration and the appropriate remedy. The discussion that follows sets forth our tentative assumptions concerning the industry structure in terms of program production, packaging, and distribution markets. We then elaborate on the implications of this structure, of the current state of markets, and of trends within these markets. The market structure and trends provide the basis for our examination of the potential effects of high levels of horizontal concentration within the industry and the means by which they may be addressed, consistent with our statutory mandate. We then examine both the subscriber and channel occupancy limits in greater depth and present alternative approaches for setting these limits. We seek comment on our conceptualization of the market structure and the suggested regulatory approaches described below, as well as alternative regulatory approaches. Finally, the discussion below considers and solicits comment on the Commission's attribution benchmarks, as affected by the *Time Warner* decision.

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[35] *See Senate Report* at 80.

[36] *See, e.g., Implementation of Section 11(c) of the Cable Television Consumer Protection and Competition Act of 1992 Horizontal Ownership Limits,* Third Report and Order, MM Docket No. 92-264, 14 FCC Rcd 19098 (1999) ("*1999 Horizontal Order*"); *Implementation of the Cable Television Consumer Protection and Competition Act of 1992 Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996 Review of the Cable Attribution Rules*, CS Docket Nos. 98-82 and 96-85, Report and Order, 14 FCC Rcd 19014 (1999) ("*1999 Attribution Order*"); *Implementation of Section 11(c) of the Cable Television Consumer Protection and Competition Act of 1992 Horizontal Limits*, MM Docket No. 92-264, Memorandum Opinion and Order on Reconsideration and Further Notice of Proposed Rulemaking, 13 FCC Rcd 14462 (1998)("*Order on Reconsideration and Further Notice*"); *Implementation of the Cable Television Consumer Protection and Competition Act of 1992 Review of the Cable Attribution Rules*, CS Docket No. 98-82, Notice of Proposed Rulemaking, 12 FCC Rcd 12990 (1998); *Further Notice of Proposed Rulemaking, Regulations Governing Attribution of Broadcast and Cable/MDS Interests, Regulation and Policies Affecting Investment in the Broadcast Industry and Reexamination of the Commission's Cross-Interest Policy*, MM Docket Nos. 94-150, 92-51 and 87-154, 11 FCC Rcd 19895 (1996); *Implementation of Section 11(c) of the Cable Television Consumer Protection and Competition Act of 1992, Vertical Ownership Limits,* Memorandum Opinion and Order on Reconsideration of the Second Report and Order, 10 FCC Rcd 7364 ("1995 Reconsideration Order"); *Second Report*, 8 FCC Rcd 8565 (1993): *Implementation of Sections 11 and 13 of the Cable Television Consumer Protection and Competition Act of 1992 Horizontal and Vertical Ownership Limits, Cross-Ownership Limitations and Anti-trafficking Provisions,* MM Docket No. 92-264, Notice of Proposed Rulemaking, 8 FCC Rcd 210 (1992) ("*Initial Notice*").

[37] *See* 47 U.S.C. § 533(f)(2)(C); *see also Time Warner*, 240 F.3d at 1133, 1139.

III. MARKET DESCRIPTION AND IMPLICATIONS

A. Markets for Programming Networks and Distribution

8. One way to describe the markets involved in creating programming and delivering it to consumers is to recognize three separate but interrelated markets: (1) the production of programming, (2) the packaging of that programming, and (3) the distribution of that programming to consumers, either by free over-the-air broadcast or by subscription via cable, wireless, or satellite, for example.[38] We believe that producers and purchasers in each market operate separately to some extent, but there also is some degree of vertical integration between these markets, which may or may not affect production and purchase decisions.

9. **Market for Program Production:** We understand that producers of programming, using specialized inputs and "talent," and non-specialized inputs,[39] create programs for sale and/or distribution. Programming may be classified into two broad categories: (a) general entertainment, and (b) niche programming. The relevant geographic market for general entertainment programming is at least national, and, to some extent, international. The geographic market for certain types of niche programming may also be national or international in scope. An example would be programming that appeals to a narrowly defined interest group across a broad geographic area such as golf fans (e.g., the Golf Channel). Other types of niche programming, such as regional sports programming, for example, have a much narrower geographic market. We believe that the market for program production is vertically integrated to some degree with the market for program packaging (*e.g.*, USA Networks owns USA Studios and Disney owns the Disney Channel as well as extensive film production facilities). We seek comment on our conceptualization of the market structure, as well as comment on additional categories of programming that might impact our analysis.

10. **Market for Program Packaging:** We assume that the market for the packaging of video programming consists of entities of various size, from unaffiliated packagers that own one programming network to large corporations, such as Time Warner and Discovery, which own many 24-hour networks. Companies that own programming networks produce their own programming and/or acquire programming produced by others. These companies then package and sell this programming as a network or group of networks to MVPDs for distribution to consumers. Networks are therefore aggregators of the product of program producers, and, through their selection of programming and payments to producers, assume part of the risk and fixed costs of program producers.[40] Over-the-air broadcast networks are also

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[38] Although cable, wireless, and satellite currently are the only technologies in use for distribution of subscription video services, other technologies may become commercially viable. Streaming video over the public Internet or over private, non-cable, fiber-optic networks are examples of such technologies.

[39] More specifically, program producers use both labor and non-labor inputs in program production. Labor inputs may be divided into two groups. The first group consists of stagehands, cameramen, film editors, and similar craftsmen. This group is characterized by relatively homogeneous resources that are readily available to the industry. The second group of labor inputs includes specialized or "talent" inputs, which may consist of actors, directors, writers, and producers. These resources are heterogeneous with respect to the salaries they can command in the marketplace, their ability to produce output which appeals to large audiences, and their ability to earn in their best alternative occupation, i.e., their opportunity cost. As a result, they are higher cost and have fewer available substitutes. *See New Television Networks: Entry, Jurisdiction, Ownership and Regulation,* Network Inquiry Special Staff, FCC, Oct. 1990.

[40] For purposes of this *Further Notice*, we simplify the discussion below by referring to MVPDs only as distributors of programming content.

purchasers of programming content. They package programming *and* distribute it to consumers through network-owned stations, affiliates, and independent stations. All broadcast networks also own some production facilities and so are vertically integrated with program production, but tend to broadcast both independently produced and affiliated programming. Over-the-air broadcast networks have an interesting role in relation to the MVPD industry: they compete with MVPDs for advertising revenue but are also carried as content on MVPD systems. Because of must carry regulations, in fact, content that is carried on over-the-air broadcast networks is generally guaranteed carriage on cable systems. We seek comment on the extent to which the must carry rules limit the barriers that a cable system can place between programmers and consumers.

11. We understand that video programming networks sell programming to MVPDs based on contracts generally lasting several years or more. Video programmers[41] are compensated through license fees that are calculated per subscriber per month. These license fees are negotiated based on "rate cards" that specify a top fee, but substantial discounts are negotiated based on the number of subscribers to which the MVPD will transmit the network and on other factors, such as placement on a particular tier. Video programmers also derive revenue by selling advertising. Advertising time on programming networks is generally split between the programmer and the MVPD.

12. We believe that the relevant geographic market for video program packaging can be regional, national, or even global in scope depending on the nature of the programming under consideration. For instance, some programming networks offer programming of broad interest, similar to that of the over-the-air broadcast networks, and depend on a large, nationwide audience for profitability.[42] Other programming networks also seek large nationwide audiences, but offer content that is more focused in subject.[43] These networks purchase highly desired programming within their areas of interest at considerable cost, and appear to strive for dominance within their niches to support the cost of providing such programming. Another subtype of network is that which still seeks nationwide distribution, but offers narrowly tailored programming, focusing on a "niche within a niche."[44] A fourth type of programming network does not seek a national audience, but is regional or even local in scope, including regional sports and news networks. Other categories include premium movie networks (such as HBO and Showtime), home shopping channels (such as QVC), and pay-per-view movie channels. Some channels, such as MTV, CNN, and The Discovery Channel, even seek worldwide distribution.[45]

13. Our brief description above does not provide a rigorous method of classifying types of programming networks, for many distinctions are possible. Instead, it merely highlights the fact that different types of networks seek out, or can be supported by, different sizes of audiences. Some programming networks likely can survive with distribution to a few million subscribers within a certain

[41] The terms "video programming networks" and "video programmers" are used inter-changeably hereafter to describe companies that package programming into networks for transmission over MVPD distribution systems. We are simply using common terminology, not collapsing the program production and program packaging markets, as the term "video programmer" might imply.

[42] Examples include TNT and USA.

[43] Examples of the second type include ESPN for sports and CNN for news.

[44] Examples of this third type of programming include Discovery Health, the Golf Network, and Home and Garden.

[45] MTV, including regional versions of the service, is said to reach 340 million households in 140 countries. *See* www.viacom.com. The Discovery Channel and its affiliated services are said to reach 425 million viewers in 152 countries. *See* www.discovery.com.

region; others may need nationwide distribution to a large percentage of MVPD homes in order to remain viable.[46]

14. We believe that program packagers seek to reach the widest range of subscribers for their type of programming on a regional or national basis to increase the value of their programming to advertisers, and to build brand recognition that will in turn spur other MVPDs to carry their programming. MVPDs as buyers of programming from video programming networks attempt to negotiate favorable license fees based, in part, on their total number of subscribers. In addition, MVPDs often receive a portion of the advertising time on the networks they carry.[47] Although some program packagers are vertically integrated with MVPDs, many program packagers are unaffiliated with any MVPD.[48] We seek comment on our description of the market for program packaging.

15. *Characteristics of Programming Networks*. We believe that video programming networks are similar in at least one respect to the over-the-air broadcast networks that we examined in the *Dual Network NPRM*.[49] Consumption of the programming of a video programming network, whether broadcast or cable, by one viewer does not reduce the amount of the good available for another viewer. This implies that most if not all of the costs of transmission are fixed since the marginal cost of showing the program to one additional viewer is near zero.[50] This in turn implies that, assuming everything else remains constant, video program packagers will always prefer to transmit to larger audiences, measured either through audience ratings or number of subscribers to whom the programmer is carried, because larger audiences bring in greater license fees and advertising revenues, but add little or no additional cost. However, some MVPDs (e.g., cable overbuild and DBS) compete with incumbent cable operators to varying degrees. This competitive effect may induce some program packagers to delay signing a licensing agreement with a new entrant for fear of being dropped by the incumbent MVPD. Alternatively, this fear may encourage the program packager to request that the new entrant accept an unreasonably high licensee fee. We seek comment on whether new entrants have experienced these effects when attempting to complete a licensing agreement with program packagers, and the extent to which these effects vary with the size of the subscriber base of the incumbent MVPD. Finally, the high fixed cost associated with developing a program indicates that a program packager needs to have access to a critical number of viewers in order to avoid a financial loss. We seek comment on the extent to which this financial risk places some program packagers at a substantial negotiating disadvantage vis-à-vis MVPDs. We also seek comment on the extent to which bargaining power differs across program packagers, i.e., between so-called marquee and non-marquee program packagers.

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[46] The fact that different types of programming networks can be supported by different sizes of audiences might be relevant in the context of the "open field" regulatory approach, discussed in ¶¶ 53-54, *infra*.

[47] Most large MSOs (Cablevision in the New York market is a notable exception) have a presence in many markets across the country, not just within one locality or region. Networks and MVPDs that have national distribution tend to be more attractive to national advertisers while those with a strong regional presence (e.g., with large regional clusters), tend to appeal to local advertisers.

[48] For a discussion regarding the status and trend in vertical integration, *see* ¶¶ 77-80, *infra*.

[49] *See Amendment of Section 73.368(g) of the Commission's Rules -- The Dual Network Rules*, MM Docket No. 00-108, Notice of Proposed Rule Making, 15 FCC Rcd 11253, 11257-61 (2000) ("*Dual Network NPRM*").

[50] In this discussion, we are referring to the marginal costs of transmission to additional consumers *once it is created or purchased*. This is distinct from the marginal cost of *producing and acquiring content*, which will not be zero. *See* ¶ 37, *infra* for a further discussion of this relationship.

16. Further, we understand that many of these fixed costs are sunk, or, in other words, deployed in uses that are specialized and therefore cannot be re-deployed to other uses if the demand for the original use declines or disappears. Specifically, once a programming network produces or acquires programming, there is no use for it other than to sell it to MVPDs for transmission to consumers. When production costs are largely sunk, the risk associated with production increases. Allocation of this risk is likely a major issue in negotiation of carriage contracts, and may explain in part the equity stakes (a form of risk sharing) that some MVPDs have in such program packagers.[51]

17. It appears that innovation is an important factor in entry and competition. In such a market, incumbency can confer large advantages. We seek comments on the value of incumbency in the programming market. It also appears that such value may be magnified by two factors. First, MVPDs may be averse to carrying latecomers in a programming niche, particularly those that are only slightly differentiated from existing programming since MVPDs have an incentive to avoid carrying programming that is a close substitute for programming already carried. Such close substitute programming may reduce the ratings of the already carried programming. At a minimum, this characteristic will disadvantage latecomers in carriage contract negotiations, leading to lower license fees and unfavorable advertising splits. Second, the brand name of pre-eminent networks has been extended through the launch of additional affiliated networks.[52] Networks with powerful brand names may be able to make carriage of their newer networks a requirement of carriage contracts, further increasing their dominance of a programming niche, and limiting channel space available for, or interest in, rival networks in the same niche. In sum, although individual packagers in the network market may differ in terms of the nature of the packager and the audience reach, generally the market may be characterized as favoring early entrants and as having large fixed or sunk costs, which packagers seek to recover through increased access to consumers.

18. **Market for the Distribution of Video Programming:** MVPDs bundle programming networks into groups of channels or "tiers" and sell this programming to consumers, deriving revenues from subscription fees and the sale of advertising time that they receive through their carriage agreements. MVPDs range in size from single-system cable operators with only a few dozen subscribers, to MSOs that own many systems and serve millions of subscribers.

19. The relevant geographic scope of the third market, the distribution of multi-channel video programming by MVPDs, previously has been defined by the Commission as local.[53] Cable services are

[51] In the video program packaging market, the critical inputs appear to include rights to valued programming, early entry into a programming niche, and network brand name. A prime example of this is the market position of ESPN, the pre-eminent 24-hour sports programming network. ESPN was the first national programming network to enter this market, combining live sports events with sports news programming. As the first, and, for many years, only 24-hour sports network, ESPN built a highly regarded brand name (i.e., valued by many customers) that allowed it to acquire valuable sports programming. ESPN's brand name also appears to give it a powerful advantage over rivals in negotiations for new contracts. Often, first movers in the video program packaging market enjoy lasting advantages. Latecomers can enter and survive by emulating the incumbent or by providing a differentiated product. *See generally* Daniel L. Rubinfeld and John Hoven, Antitrust Division, U.S. Department of Justice, *Innovation and Antitrust Enforcement*, presented at the Conference on Dynamic Competition and Public Policy in Washington, D.C. on Dec. 16, 1998.

[52] For instance, ESPN launched ESPN2 and ESPNews, and Discovery launched Animal Planet and Discovery Health.

[53] *In the Matter of Application for Consent to the Transfer of Licenses and Section 214 Authorizations from Tele-Communications, Inc., Transferor, to AT&T Corp., Transferee,* 14 FCC Rcd at 3172-73. *See Sixth Annual Report*

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furnished in local franchise areas by one or more MVPDs, and consumers cannot switch to another MVPD that does not offer service within that area. Most franchise areas are served by only one cable operator. In a limited, but growing, number of franchise areas, a second cable operator ("overbuilder") or multi-channel multipoint distribution services ("MMDS" or "wireless cable") operator also offers service. Satellite master antenna television ("SMATV") providers[54] do not provide competition throughout a local franchise area because they generally offer service only where they may do so without crossing public rights-of-way. SMATVs offer services largely to institutions, such as universities and hospitals, and to multiple dwelling units ("MDUs"), such as apartment buildings and cooperatives. Direct broadcast satellite ("DBS") providers also distribute MVPD services and are available nationwide to consumers who have an unobstructed view of the southern sky from their homes or place of residence. While there are some differences among these distribution technologies and each has its own limitations and advantages, they offer consumers similar services.

20. *Recent Trends in Multi-Channel Video Programming Distribution Market.* The current MVPD market differs from that which existed when Congress enacted the subscriber and channel occupancy provisions of the 1992 Act. These differences must inform our examination of our rules. In 1992, competition was limited to a small percentage of local markets. Specifically, Congress found that cable was the "dominant nationwide video medium," with "over 60% of the households with television" subscribing to cable, a percentage "almost certain to increase."[55] In contrast, home satellite delivery (HSDs) served only an estimated two-to-three million subscribers;[56] MMDS served only an estimated 350,000 subscribers;[57] DBS, although authorized, was not yet operational;[58] and telephone companies were barred from providing video programming within their service areas.[59] Further, there was minimal local competition between cable systems: out "of over 11,000 cable systems nationwide . . . only 53 . . . have some overbuild."[60]

21. By June 2000, cable operators served 67.7 million subscribers (an increase of 22.6 percent since 1992); DBS served over 10 million subscribers (from zero in 1992); HSD served 1.5 million subscribers (a reduction of 24 percent from 1992); MMDS served 700,000 subscribers (an increase of 133 percent over 1992); and SMATV served 1.5 million subscribers.[61] Additionally, overbuild activity has

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on Competition in Video Markets, 14 FCC Rcd at 987-1070, for details on the cable industry and its competitors. It should be noted, however, that the Commission has determined that for purposes of assessing the impact of horizontal concentration, it is appropriate to examine "both the national programming market and the local distribution market," because cable operators generally acquire programming on the national level and distribute it on the local level through their locally franchised systems. *See Order on Reconsideration and Further Notice*, 13 FCC Rcd at 14477.

[54] SMATV providers are also known as private cable operators.

[55] 1992 Act § 2(a)(3).

[56] *See Senate Report* at 15; *House Report* at 45.

[57] *See Senate Report* at 14; *House Report* at 44.

[58] *See Senate Report* at 16; *House Report* at 46.

[59] *See Senate Report* at 17-18.

[60] *Id.* at 13.

[61] *See Seventh Annual Report*, 16 FCC Rcd at 6010-13. It should be noted that neither the *Senate Report* nor the *House Report* cited SMATV figures for 1992. However, in 1994, SMATV was reported to serve one million

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increased: second franchises have been awarded in 369 communities."[62] Based on the figures above, in 1992, cable and non-cable multi-channel programming providers served 95.5 percent and 4.5 percent of the MVPD subscribers, respectively. In contrast, cable's current share of MVPD subscribership has decreased to 80 percent, and non-cable's share has increased to 20 percent, of which 15 percent is attributable to DBS.[63] Thus, although cable continues to be the dominant player in the MVPD market, its market share has diminished somewhat with the emergence and continued growth of competing MVPD providers.

22. Perhaps the most important difference between the industry in 1992 and today is that in 1992 there was no clear nationwide substitute for cable.[64] Today, on the other hand, DBS has a national footprint and, although there are questions concerning DBS' ability to constrain cable prices,[65] it appears that DBS currently offers an effective alternative path through which program networks can reach subscribers. DirecTV now is the third largest MVPD operator, after AT&T and Time Warner, and EchoStar is the eighth largest.[66] In addition, it appears that the competitive presence of DBS reduces 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.[67] We seek comment on the impact of DBS' presence on cable operators' market power generally and on their ability to select programming for reasons other than quality and/or viewer interest. We also seek comment on the extent to which advertisers view DBS as an effective substitute for cable in reaching viewers.

23. Not only has the MVPD market become somewhat more competitive, the cable industry has become more dynamic. For instance, two MSOs that now are among the ten largest cable MSOs, Charter and MediaCom, recently were created either through acquisitions or combinations of smaller MSOs. In addition, RCN, a relatively new MVPD, has grown to one of the 20 largest MSOs through a

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subscribers. *See Implementation of Section 19 of the 1992 Cable Act (Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming)*, CS Docket No, 94-48, First Report, at Table 5.1 ("*1994 Annual Report*"). Thus, between 1994 and 2000, SMATV realized a 50 percent increase in subscribership.

[62] *See Seventh Annual* Report, 16 FCC Rcd at 6024-25.

[63] *Id.* at Appendix C, Table C-1.

[64] C-Band satellite was available nationally, but the size and cost of the equipment required to access the service, among other things, rendered C-Band service an ineffective competitor to cable in most settings.

[65] *See Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992, Statistical Report on Averages Rates for Basic Service, Cable Programming Services, and Equipment,* MM Docket No. 92-266, Report on Cable Industry Prices, 16 FCC Rcd 4346 (2001) ("*2000 Price Survey*"). Results from an econometric model presented in this report suggest that DBS is a substitute for cable services. This result is different from earlier findings that showed DBS exerting only a modest influence on the demand for cable services. *See, e.g.,* 15 FCC Rcd at 10946 (2000).

[66] *See Seventh Annual* Report, 16 FCC Rcd at Appendix C, Table C-3.

[67] By "quality," generally we mean programming that consumers value and are willing to pay for. The ability of cable operators to choose programming for reasons other than consumer demand, e.g., based on affiliation, would indicate that cable operators have a degree of market power.

combination of incumbent cable systems, overbuild cable systems, and open video systems.[68] We believe that the growth of non-cable MVPD competitors, in combination with the creation and success of new mid-sized MSOs, provides new outlets for programmers. We seek comment on this assumption.

24. This is not to suggest that consumers necessarily enjoy the effects of strong competition in the MVPD market. Rather, it simply points to the fact that there are alternatives to cable available to consumers and programmers today that were not available in 1992. We examine the nature of this competition below, with particular attention to the level at which competition can be deemed effective for purposes of both the subscriber and the channel occupancy limits. Effective competition, in this context, seems to mean competition sufficient to provide alternative means for programmers viably to reach consumers, thus protecting consumer choice and welfare. Below we seek comment supported by empirical evidence on the appropriate measure for determining when effective competition is reached in this context.

25. Additionally, as discussed in Section V on vertical limits, another important difference between today's competitive landscape and that of 1992 is the increase in the number of channels available on MVPDs. In 1992, a majority of cable systems had a channel capacity of between 30 and 53 analog channels.[69] Today, cable systems, on average, offer 80 analog channels, and cable operators continue to expand capacity through upgrades of cable plant.[70] Digital cable increases capacity even further, allowing transmission of six or more digital channels through the capacity formerly required by one analog channel. Indeed, DBS operators already offer hundreds of digital channels.

26. A principal objective of the subscriber limit provisions of Section 613(f) was to encourage development, innovation, and competition in the market for video programming by limiting concentration among cable operators, and the associated bargaining power of cable operators. Excessive bargaining power could enable cable operators to reduce unduly the economic returns of programmers, causing them to curtail their activities and thereby limit the quality and diversity of programming fare.[71] The task we face is to determine how to implement that congressional intent in today's dynamic MVPD marketplace. Below we describe the potential effects of high levels of concentration followed by a discussion of the implications of current market conditions.

B. Potential Effects of High Levels of Cable Concentration

27. To examine the effects of high levels of ownership concentration in the cable industry, we consider a hypothetical setting in which the absence of government restrictions enables substantial MVPD concentration. This exercise allows us to consider the potential harms and benefits of high levels of concentration.

28. **Potential Harms Resulting from Concentration:** There are several potential negative effects of high levels of concentration. First, as the Commission articulated in the *1999 Horizontal*

[68] The 1996 Act established open video systems ("OVS"), which is a regulatory category that can apply to any type of MVPD facility and generally is characterized by reduced regulatory burdens. *See* 47 U.S.C. § 573; *see also* 47 C.F.R. §§ 76.1500-14.

[69] *See House Report* at 31.

[70] *See Seventh Annual Report*, 16 FCC Rcd at 6017-18.

[71] *See* ¶ 3, *supra.*

Order, in a highly concentrated market, one or several MSOs could unfairly impede programming flow, either individually or through joint action. With such action, a single MSO or multiple MSOs might be able to determine the success or failure of a programming network, an outcome Congress sought to prevent.[72] We seek comment on the possibility of such action, including evidence that such action may have occurred in the past.

29. Second, large MSOs might gain power to affect vertical relationships and horizontal concentration within the industry. With regard to vertical relationships, MSOs with large programming interests may unfairly favor affiliated programming over unaffiliated programming. Another possibility is that a vertically integrated MSO may use its ties to affiliated networks to strategically create barriers to entry or otherwise disadvantage competing MVPDs by making access to affiliated programming more difficult.[73] Moreover, as discussed above, large MSOs have the ability to command large discounts on license fees from video programming networks, forcing prices toward marginal cost.[74] Networks may not have an incentive to enter the market or to be innovative in their programming if they do not anticipate being able to recover the fixed/sunk costs of network program development. This would impede "…the flow of video programming from the video programmer to the consumer" contrary to congressional intent.[75] We seek comment and empirical evidence on whether this problem has occurred in the past or is likely to occur if MSOs are not constrained by a subscribership limit. We also seek comment and empirical evidence regarding possible market solutions to this problem.

30. With regard to horizontal concentration, we have received comment in previous proceedings concerning the ability of large MSOs to disadvantage overbuild entrants due to the large programming license fee discounts the incumbents receive and by gaining exclusive contracts for nonaffiliated or terrestrially delivered programming.[76] At sufficiently high levels of concentration among

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[72] Such a result is directly contrary to 47 U.S.C. § 533(f)(2)(A), which directs the Commission to "ensure that no cable operator or group of cable operators can unfairly impede, either because of the size of any individual operator or because of joint actions by a group of operators of sufficient size, the flow of video programming from the video programmer to the consumer."

[73] It should be noted that the Commission's Program Access rules ensure that competing MVPDs have nondiscriminatory access to satellite delivered affiliated programming. The rules, however, do not cover terrestrially delivered programming or non-affiliated programming. For a discussion of the effect of vertical integration on the supply of programming, see*, e.g.,* Waterman, David and Andrew A. Weiss, *Vertical Integration in Cable Television*, The MIT Press and The AEI Press, 1997 at 55-86 ("*Waterman and Weiss*"). For a more general discussion of the effects of vertical integration, see Riordan, Michael H. and Steven C. Salop, "Evaluating Vertical Mergers: A Post-Chicago Approach, *Antitrust Law Journal*, Vol 63, 1995.

[74] For an alternative view, see, *e.g*., Chipty, Tasneem and Christopher M. Snyder, "The Role of Firm Size in Bilateral Bargaining: A Study of the Cable Television Industry," *Review of Economics and Statistics,* Vol 81, May 1999, at 338. Chipty and Snyder analyze the effects of mergers in terms of upstream and downstream efficiency gains and the bargaining process that takes place between cable operators and programming networks using 1993 data. Results of their study indicate that, in the absence of efficiency gains, mergers tend to reduce rather than enhance cable operators' bargaining position vis-à-vis programming suppliers because mergers generally reduce the amount of surplus revenue (advertising revenue minus the cost of producing programming) available for operators to appropriate from programming networks during negotiations. Within the framework of the Chipty and Snyder model, however, the primary explanation for mergers is upstream and downstream efficiency gains rather than increased bargaining power.

[75] 47 U.S.C. § 533(f)(2)(A).

[76] *See Seventh Annual Report*, 16 FCC Rcd at 6075.

cable MSOs, overbuild entrants and even DBS operators may be forced to pay programming license fees that are so high that continued operation is unprofitable. Cable MSOs with a disproportionately large number of subscribers may also be able to convince video programming networks not covered by program access rules to grant them exclusive rights at the expense of smaller competitors.[77] Since exclusive contracts would deny some programming to subscribers of alternative MVPDs, this would be contrary to congressional intent.[78] Such a situation could also harm consumers through a lessening or elimination of competition. Since competition can create incentives to offer a wider variety of programming and new services, it would appear that the lessening of competition may also impede the flow of programming to the consumer. We seek comment and empirical evidence on whether this problem has occurred in the past, or is likely to occur if MSOs are not constrained by an ownership limit. Empirical studies that examine the viability of DBS and overbuild competitors at various levels of cable concentration would be particularly helpful. A convincing showing that effective competition would be curtailed at a certain level of horizontal concentration in the cable industry might indicate an appropriate limit. We also seek comment on and empirical evidence regarding the ability of an independent DBS industry to provide a profitable outlet for programming networks, and we seek comment on how many subscribers DBS must serve in order to serve this function.

31. A third potential problem with MSO concentration relates to innovation and long-term performance in the MVPD market. If one or two MSOs came to dominate the cable industry, they might experience diminished incentive to innovate, either through upgrades and improvements in their plant and their customer service, or their program offerings? Some economists argue that monopolists are insufficiently motivated to minimize costs and to innovate, and therefore incur "X-inefficiencies."[79] We seek comment on, and empirical evidence to support the idea that larger MSOs are less innovative and more subject to X-inefficiencies. We also seek comment on whether horizontal ownership limits encourage entry into MVPD markets, and whether such increased entry would reduce the likelihood of X-inefficiencies.

32. A fourth potential problem relates to the competition *for* markets, not competition within markets. All cable systems in the United States are locally franchised, and local franchising authorities ("LFAs") review franchisee performance at renewal time. It is possible that the existence of multiple MSOs provide LFAs with alternatives at least as a means to compare the performance of the incumbent against other operators, referred to in the literature as "benchmarking."[80] If so, then the existence of

[77] *See Waterman and Weiss* at 148 for a discussion of possible modifications to the Commission's program access rules that would cover such circumstances.

[78] *Id.*

[79] X-inefficiency arises in a situation where the lack of competitive pressure leads management and employees to use their inputs less effectively than they could. As a result, costs are higher in monopoly markets than in competitive markets. More formally, according to Leibenstein, who coined the term, X-inefficiency is "... the extent to which a given set of inputs do not get to be combined in such a way so as to lead to maximum output." *See* Harvey Leibenstein, "Competition and X-Efficiency," *Journal of Political Economy*, May 1973, at 766. *See also* Harvey Leibenstein, "Allocative Efficiency vs. 'X-Efficiency,'" *American Economic Review*, Vol. LVI 1966, at 392-414 and William S. Comanor and Harvey Leibenstein, "Allocative Efficiency and the Measurement of Welfare Losses," *Economica*, Vol. XXXVI, Aug. 1969, at 304-09.

[80] *See, e.g.*, *In the Applications of NYNEX Corporation Transferor, and Bell Atlantic Corporation Transferee, for Consent to Transfer Control of NYNEX Corporation and its Subsidiaries, Memorandum Opinion and Order*, File No. NSD-L-96-10, 12 FCC Rcd at 20058-60 (1997), for a discussion of regulatory benchmarking.

multiple MSOs could provide a helpful check on MSO practices in their franchise areas.[81] Further, under some circumstances, it may be helpful for LFAs to refer to franchise agreements negotiated in other franchise areas with different MSOs, particularly as evidence that elements of those franchise agreements are not financially ruinous.

33. We recognize that LFAs' ability to review incumbent cable systems' offerings is limited. The 1992 Cable Act bars LFAs from considering incumbents' "mix or quality" of specific programming at renewal.[82] This limitation does not, however, prevent LFAs from considering generally whether incumbents' renewal proposals are reasonable in terms of community needs and interests.[83] Therefore, we believe that there is some potential for using other cable operators' offerings and performance to influence the behavior of an incumbent cable operator.

34. We seek comment and empirical evidence on whether LFAs actually use the performance of other MSOs in order to discipline the behavior of their franchisees, and on how extensive this disciplining effect is. Do LFAs rely on the ability to refer to franchise agreements negotiated in other franchise areas? Would small LFAs be greatly disadvantaged in franchise renewal negotiations if the market consisted of only a few extremely large MSOs? We also seek comment regarding the ability of a start-up cable firm to take over an under-performing franchise at renewal time. Again, we are interested in the relevance of deep programming discounts that an extremely large MSO might command. At what point would such discounts make competition economically infeasible, and thus eliminate the helpful effects of potential entry?

35. A fifth potential problem with MSO concentration stems from the effects of high levels of concentration on programming choices offered by MVPDs to their subscribers. Some economists have argued that a monopoly MVPD would provide fewer choices among similar types of programming and charge higher prices for that programming than competitive MVPDs.[84] This is because a monopolist will not offer new programming that significantly reduces the demand for existing programming and thereby reduce the revenues generated by the existing programming. This consideration, coupled with a monopolist's pricing power, could result in higher prices and a more limited selection of programming. Competitive MVPDs, on the other hand, are likely to offer programming networks that include substitutes as long as that programming generates sufficient revenues to cover program production costs.[85] We seek comment on the possible effects of the level of concentration on programming choice. In particular, we seek comment and empirical evidence on whether very large MSOs would carry less programming content or less diverse content than consumers would desire.

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[81] Overbuilders might be able to fulfill this role if they were able to be competitive in a world with only a single MSO, or several very large MSOs.

[82] *See* 47 U.S.C. § 546(c)(1)(B).

[83] *See* 47 U.S.C. §§ 546(c)(1)(C), (D); *see also Senate Report* at 47.

[84] *See, e.g.,* Owen, Bruce M., and Steven Wildman, *Video Economics,* Harvard University Press, 1992 at 116 ("*Owen and Wildman"*). Also, *see* Spence, A. Michael, and Bruce Owen, "Television Programming, Monopolistic Competition, and Welfare," *Quarterly Journal of Economics*, 1977 at 112.

[85] Alternatively, to the extent that a monopolist MVPD may tend to offer a programming line-up that does not include many highly similar programming networks, it tends to reduce program duplication and thereby may provide a greater variety of programming. This outcome has been simulated in economic models that demonstrate that a monopolist has an incentive, other things being equal, to offer a greater variety of programming than do firms that compete with each other. *See Waterman and Weiss* at 63 and *Owen and Wildman* at 100.

36. **Potential Benefits of Concentration:** There are also potential positive effects of MSO concentration. Some economists, most notably Schumpeter, suggest that monopoly can be more conducive to innovation than competition, since monopolists can more readily capture the benefits of innovation.[86] Moreover, a concentrated market may enjoy efficiencies as a result of economies of size and scale. In addition, the operator with increased bargaining power may pass some of its savings on to consumers in the form of lower rates (or smaller rate increases).

37. Another potential benefit of concentration stems from the characteristics of video programming. As noted above, the viewing of video programming by one person does not lower the amount of programming available for consumption by others. Programming also involves low marginal cost for additional distribution, and high sunk and fixed costs.[87] Theoretically, a high level of concentration among MVPD providers might mitigate some of the problems associated with such characteristics. As an example, an MVPD market having a single provider would not experience the problem that could result when programmers try to recover revenues lost to discounts granted to large MSOs by charging higher fees to smaller MSOs.[88] This problem might be avoided in a single MVPD scenario since the program distributor (i.e., the MVPD) would absorb a greater amount of the sunk costs incurred in the production of new programming (analogous to the "first copy" costs in publishing) in order to ensure the economic viability of essential programmers, and thus the continued supply of high quality programming.[89] This potentially could increase the supply of high quality and diverse programming to consumers by reducing the risks associated with the production and acquisition of programming.

38. We seek comment on the empirical evidence of whether small MSOs absorb most of the first copy costs associated with program production. This issue seems likely to be most pressing when there is a single large cable MSO and several smaller cable and non-cable MVPDs. By contrast, in a highly fragmented market in which no MVPD could command significant programming discounts, this type of problem tends to dissipate. We seek comment on the effect of a heavily concentrated cable sector on the ability of programmers to recover all relevant operating costs and on non-cable competitors' ability to acquire programming at competitive rates.

39. This potential benefit associated with high levels of concentration, however, depends upon several factors that are not likely to occur in practice. In a highly concentrated industry, operators may demand excessive discounts from programmers because of the market power they enjoy. Because MVPDs depend upon programmers for content, even a monopoly MVPD would not *knowingly* harm

[86] *See, e.g.*, Schumpeter, Joseph, *The Theory of Economic Development*, Oxford University Press (1961).

[87] *See* ¶ 15, *supra.*

[88] Generally, this problem can arise in a setting with large fixed costs of production and near-zero costs for distributing the product to additional buyers. This can cause a failure to recover completely the high sunk costs involved in production, including program production costs. In the current market, large MSOs may have sufficient bargaining power to be able to command programming license fee discounts that are so large that they enable video programming networks to recover only their variable costs and not their sunk costs of programming production. Video program networks that provide such discounts may be compelled to recoup costs by charging smaller MVPDs, which have less bargaining power, higher license fees to offset the discounts demanded by the larger MSOs. In principle, this problem may be reduced by vertical integration or other forms of investment alliances. *See Waterman and Weiss* at 74.

[89] Theoretically, another possible solution to this type of problem is a highly fragmented market in which no single entity has the bargaining power required to command discounts.

programming networks by demanding excessive discounts. In order to avoid harming programmers, however, the operator would have to have an intimate knowledge of the programmers' cost structure, which is unlikely in practice.[90] As a result, the operator might unwittingly force video programmers to accept compensation that does not cover all of their relevant costs, thus reducing programmers' ability to provide high quality programming or, possibly, forcing some out of business. In addition, in the absence of meaningful competitive alternatives, customers may continue to purchase the product of the dominant MVPD operator even if the quality of that product declines. This would enable the operator to choose programming for reasons other than quality, such as the desire to ensure the profitability of an affiliated programmer.

40. In view of the potential benefits and harms of concentration, on balance, it appears likely that high levels of concentration have the potential to harm both consumers in downstream markets and programming suppliers in the upstream market. Moreover, Congress has expressed a concern that concentration in downstream markets would be detrimental to MVPD consumers generally and to the health of the video program packaging industry specifically. In meeting congressional intent and fulfilling our mandate under Section 613(f), we believe it is incumbent upon us to fashion regulations that would preclude a single MSO from serving all cable subscribers nationwide. We seek comment on this conclusion.

C. Implications of Current Market Conditions

41. As discussed in our description of the programming markets, we have observed two trends in the MVPD marketplace - - increased competition from DBS and expanded channel capacity through system upgrades and the use of advanced digital technologies. These two trends may reduce the potential harm to video program networks that could flow from increased concentration in the cable industry. Indeed, even if a single MSO owned or controlled all cable systems, a programmer denied access to its cable subscribers now might be able to reach millions of consumers through DBS.[91] Still, it is possible that substantial concentration could create an environment in which a single large MSO could determine independently the success or failure of video programming networks, an outcome Congress sought to prevent.[92]

42. As discussed above, economic studies dealing with both horizontal concentration and vertical integration in the cable industry show that there may be potential benefits as well as costs associated with such concentration and integration at levels similar to those found in the industry today.[93]

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[90] For instance, it is unlikely that Cox, which owns no programming networks, has any detailed information regarding the cost structure of ESPN, a programmer with no MSO affiliation.

[91] For example, NFL Direct Ticket reaches consumers exclusively through DirecTV, and Echostar carries certain ethnic programming exclusively. These programmers were not denied access to cable subscribers, but their carriage on DBS demonstrates that it is possible to reach consumers through means other than cable systems.

[92] We also recognize that cable concentration may have implications for services that are new or under development, such as interactive programming services. Although it is impossible to measure the effect of cable concentration on services that are as yet undefined, our rules should be designed to promote a fertile environment in which such services may grow and develop.

[93] *See generally* Chipty, Tasneem, "Horizontal Integration for Bargaining Power: Evidence From the Cable Television Industry," *Journal of Economics & Management Strategy*, Vol. 4, Summer 1995, at 375-97; Ford, George S. and John D. Jackson, "Horizontal Concentration and Vertical Integration in the Cable Television Industry, *Review of Industrial Organization*, Vol. 12, 1997, at 501-18; *Waterman and Weiss* at Chapter 7; Shooshan, Harry

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As competition increases and the number of distribution outlets grows, the buying power of each entity typically decreases, as do the opportunities for vertical foreclosure. It also appears that there is increasing diversity within the video programming market as a result of large increases in channel capacity over the past several years (*e.g.*, MSNBC and FoxNews have been able to emerge as competitors to CNN despite CNN's first mover advantage in that market). In addition, because video programming is critical to program packagers and programming networks are critical to MVPDs, each level in the programming distribution chain has an interest in the economic health of the other levels. While these facts do not eliminate the possibility of vertical foreclosure, it appears that cable MSOs, especially in the face of DBS' nationwide reach, have an interest in offering the most competitive programming possible, regardless of its source.[94]

43. On the other hand, at much higher levels of concentration, if a cable operator had significant bargaining power, it might use that power to pay a lower price for programming than competing buyers pay, and may perceive a reduced need to secure innovative, high quality programming. The result may be that viewers receive less high quality programming. If the purchasing firm is also vertically integrated, it may find it profitable to engage in anti-competitive behavior by raising the cost of entry to rival firms in the distribution or the programming markets.[95] Moreover, as discussed above, a large firm with significant bargaining power might command price discounts for programming large enough to preclude competition from other potential entrants in the MVPD market or may be able to gain exclusive contracts for programming that damage competitors. More specifically, the costs of such a large MSO potentially could be so low that it could render overbuild startups economically infeasible, or it could force the prices that other MVPD providers pay for programming to be so high that they could no longer compete profitably with cable.[96] We seek comment on how higher levels of concentration affect program acquisition costs and also on the prevalence of exclusive distribution contracts.

44. We seek to adopt regulations that are appropriate given the market power of cable operator in today's dynamic and changing MVPD marketplace.[97] We ask commenters to address the relevance of the developments that have occurred since 1992 and those that are likely to occur in the

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M., "Cable Television: Promoting a Competitive Industry Structure," in *New Directions in Telecommunications Policy: Volume 1, Regulatory Policy: Telephony and Mass Media*, Paula R. Newberg, ed., Duke University Press, 1989, at 222-46; and TCI Comments in Docket 92-264 at App. A, Besen, Stanley and John Woodbury, *An Economic Analysis of the FCC's Cable Ownership Restrictions,* August 1998, ("*Besen and Woodbury*").

[94] There is also some question concerning the level of editorial control that MVPDs exercise over programming networks, whether the networks are vertically integrated or not. Given our three level description of the market above, it appears that most editorial decisions concerning selection of content occur when video program packagers select video program content from producers, not when MVPDs select video programming networks. This is driven by the fact that cable operators purchase video programming networks as a package, i.e., as one or more 24-hour networks. Of course, the MVPD remains the ultimate gatekeeper since it makes the final decision on the networks it will carry, and those decisions ultimately determine what programming is actually seen and heard by subscribers.

[95] An example of such behavior might include the denial by a vertically integrated MSO of terrestrially delivered affiliated programming to a rival MVPD, a situation which would not be covered under present program access rules. *See Waterman and Weiss* at 56-86 for a further discussion of anti-competitive strategic behavior.

[96] On average, programming costs account for one third of a cable system's expenses. *See e.g.*, U.S. Bureau of Census, *Annual Survey of Communication Services*, at 20 (1998).

[97] *See* 47 U.S.C. § 533(f)(2)(E); *see also* ¶¶ 21-25, *supra.*

MVPD marketplace in the future. We also ask commenters to address our conceptualization of the market structure and the ownership patterns that exist, to provide empirical or theoretical analyses that support or contradict our assessments, and to discuss the bearing such information has on the suggested regulatory approaches. Additionally, we ask commenters to discuss whether the suggested regulatory approaches adequately account for competition and market power in the industry, and whether they properly account for the elasticities of supply and demand, both in the acquisition and the distribution of multi-channel programming. In particular, we seek comment on whether increased bargaining power by programming networks renders additional concentration among MVPDs less harmful to viewers. Mindful of the Section 613(f)(2) public interest factors, we ask commenters to consider the potential beneficial and detrimental effects of the regulatory approaches suggested below.[98] We seek comment on the possible efficiencies and other service benefits, such as innovation in the distribution of programming, that potentially might be gained through less restrictive ownership limits. We also seek comment on the impact of relaxed ownership limits, which potentially could lead to fewer -- but more powerful -- gatekeepers, on the opportunities for new programming networks to successfully enter the market, on innovation in programming, and on consumer choice. With respect to each identified harm or benefit of increased concentration in cable ownership, we seek comment on: (1) the theoretical basis for the existence of such harm or benefit; (2) the empirical evidence that such harm or benefit is or is not occurring at present levels of concentration; and (3) the specific limits on concentration required to address a particular harm or the degree of concentration necessary to achieve a particular benefit. Finally, consistent with Section 613(f)(2), we seek comment on other public interest objectives the Commission should consider in reexamining the horizontal limit.

45. In light of the structural changes in the industry since the adoption of the 1992 Act, we examine the foregoing issues in more detail below with the goal of developing a regulatory approach that is consistent both with congressional intent and with the D.C. Circuit's decision in *Time Warner*.

IV. HORIZONTAL LIMIT

A. The Commission's Horizontal Ownership Rule

46. The Commission's horizontal ownership limit bars a cable operator from owning or having an attributable interest in cable systems that in the aggregate reach more than 30 percent of MVPD subscribers nationwide.[99] In setting the horizontal limit at 30 percent, the Commission sought to address

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[98] *See* 47 U.S.C. § 533(f)(2)(G); *see also* ¶ 4, *supra*.

[99] 47 C.F.R. § 76.503. Section 76.503 provides, in pertinent part:

> (a) Subject to paragraph (b) of this section, no cable operator shall serve more than 30% of all multi-channel-video programming subscribers nationwide through multi-channel video programming distributors owned by such operator or in which such cable operator holds an attributable interest.
>
> (b) Cable subscribers that a cable operator does not serve through incumbent cable franchises shall be excluded from the cable operator's limit.
>
> (c) For purposes of this section, "incumbent cable franchise" means a cable franchise in existence as of October 20, 1999, and all successors in interest to these franchises.
>
> (d) Subscribers that a cable operator serves through incumbent cable franchises shall include all subscribers served by those incumbent cable franchises, regardless of when the subscribers were added to the incumbent cable franchise.

(continued….)

congressional "concerns regarding the development of the video-programming market" on a national scale,[100] by preventing a single large cable operator or a group of operators from "collectively deny[ing] carriage to a new programmer, either by unilateral, independent decisions or by tacit collusion."[101] Analyzing industry data, the Commission estimated that a new programming cable network would need access to 40 percent of the MVPD subscribers nationwide to be viable.[102] The 30 percent limit, the Commission reasoned, would allow new programming networks access to a 40 percent "open field" by ensuring the presence of at least four cable operators in the market, and by preventing the two largest cable operators from garnering more than 60 percent of the market.[103] In this regard, the Commission explained, "… even if two operators, covering 60% of the market, individually or collusively deny carriage to a programming network, the network would still have access to 40% of the market, giving it a reasonable chance of financial viability."[104] Additionally, the Commission believed that the more MSOs there were purchasing programming, the greater the likelihood that different programming choices would be made and that diverse voices would be carried.[105]

47. The Commission recently reformulated the methodology used for calculating the 30 percent horizontal limit in an effort to better gauge MSOs' market power in the national video-programming market.[106] The current limit is based on the aggregate number of subscribers served, rather than the number of cable homes passed by an MSO's cable systems. The Commission determined that a subscriber-based calculation represented a more accurate measurement of "market power," given that cable operators deal with and purchase programming from cable networks based on the actual number of

(…continued from previous page)

(e) "Multi-channel video-programming subscribers" means subscribers who receive multi-channel video-programming from cable systems, direct broadcast satellite services, direct-to-home satellite services, multi-channel multipoint distribution services, local multipoint distribution services, satellite master antenna television services (as defined in § 76.5(a)(2)), and open video systems.

(f) "Cable operator" means any person or entity that owns or has an attributable interest in an incumbent cable franchise.

(g) Prior to acquiring additional multi-channel video-programming providers, any cable operator that serves 20% or more of multi-channel video-programming subscribers nationwide shall certify to the Commission, concurrent with its applications to the Commission for transfer of licenses at issue in the acquisition, that no violation of the national subscriber limits prescribed in this section will occur as a result of such acquisition.

* * * * *

[100] *1999 Horizontal Order*, 14 FCC Rcd at 19105.

[101] *Id.* at 19116.

[102] The 40 percent "open field" was based on the Commission's findings that in order to be viable, a new programming network needs to access approximately 15-20 million subscribers (20 percent of the market), and that, even with such access, it has only a 50 percent chance of actually reaching subscribers given tier packaging and consumer preferences. *See 1999 Horizontal Order*, 14 FCC Rcd at 19115-18.

[103] *Id*.

[104] *Id.* at 19119.

[105] *Id.*

[106] *Id.* at 19098.

subscribers they serve, not the estimated number of homes passed within their franchise areas.[107] Moreover, the limit is now calculated in terms of an MSO's share of the total (cable and non-cable) MVPD market, rather than the cable market only.[108] The Commission recognized that the MVPD landscape was evolving and viable competition was emerging, affording programmers alternative avenues for distribution and consumers more choices in multi-channel programming sources. By defining the limit in terms of a percentage of the total MVPD nationwide subscribership, the Commission sought to establish a self-adjusting scale that would take into account, and directly respond to, the dynamic and changing video programming marketplace.[109]

B. The *Time Warner* Decision

48. The D.C. Circuit found that Section 613(f)(1) authorizes the Commission to set a limit that would prevent a "single company"[110] from foreclosing entry of a programming network, but does not authorize the agency to regulate the "legitimate, independent editorial choices of multiple MSOs."[111] Thus, absent a Commission record that would support findings of, or predictive judgments regarding, collusive or other joint anti-competitive conduct among multiple MSOs, the D.C. Circuit determined that the record only supported a 60 percent limit under the Commission's 40 percent open field premise.[112] The D.C. Circuit opined that the Commission might justify a lower limit, if it could establish that a single large MSO acting alone would be able to act anti-competitively by "extort[ing] equity from programmers or forc[ing] exclusive contracts . . . while serving somewhat less than the 60% of the market (*i.e.,* less than the fraction that would allow it unilaterally to lock out a new cable programmer)."[113] It found, however, that the Commission failed to offer record evidence of anti-competitive harm in terms of a single MSO, let alone multiple MSOs.[114] Accordingly, the D.C. Circuit reversed and remanded the 30 percent horizontal limit, finding that the Commission neither justified the limit with record support, nor established that the limit did not burden speech substantially more than necessary.[115]

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[107] *Id.* at 19108.

[108] *Id.* at 19110-12. The Commission also reformulated the calculation by counting only those cable subscribers served by a MSO's existing cable franchises (as of Oct. 20, 1999), and excluding all subscribers gained through development of new, non-incumbent systems, in order to spur competition and foster overbuilding. *Id*.

[109] Under the self-adjusting scale, increases in non-cable MVPD subscribership effectively raise cable MSOs' horizontal limit in terms of the number of *cable* subscribers they may serve and reflect MSOs' correspondingly diminished market share. Given non-cable MVPD gains, the Commission concluded that the self-adjusting 30 percent horizontal limit at the time was the effective equivalent of a 36.7 percent cap of cable subscriber ownership. *See 1999 Horizontal Order*, 14 FCC Rcd at 19113.

[110] *Time Warner*, 240 F.3d at 1131.

[111] *Id.* at 1130-35 (finding that the language of Section 613(f)(2)(A) that requires the FCC to ensure that a single cable operator or a group of cable operators "jointly" could not "unfairly" impede the programming flow, requires evidence of collusive or anti-competitive conduct or theoretical basis for such conduct). *See* ¶ 4, *supra*.

[112] *Id*. at 1132-33 (accepting, but not addressing the validity of, the Commission's 40 percent open field premise).

[113] *Id.* at 1133.

[114] *Id.* at 1132-34.

[115] *Id.* at 1130, 1136.

49. The D.C. Circuit cautioned the Commission, in revisiting the horizontal limit, to identify and support any findings of anti-competitive harm,[116] and to draw "the connection between [such] harm and market power."[117] The D.C. Circuit further cautioned the Commission to consider the pervasive presence of DBS and its impact on MSOs' market power in the upstream and downstream video programming markets.[118] In this respect, the D.C. Circuit faulted the Commission for mistakenly equating market share with market power by formulating the limit in terms of a percentage of MVPD subscribers.[119]

50. Accordingly, the D.C. Circuit's decision made clear that in establishing a subscriber limit, the "government must be able to ensure that a programmer have at least two conduits through which it can reach the number of viewers needed for viability - - independent of concerns over anti-competitive conduct."[120] In addition, the subscriber limit must be set in the context of MVPDs' market power. An MVPD's market power "depends not only on its share of the market, but also on the elasticities of supply and demand, which in turn are determined by the *availability of competition*" (*i.e.,* the availability of an alternative MVPD outlet affords programmers access and consumers choice, and erodes cable's or an MSO's market power irrespective of current market share).[121] Further, the D.C. Circuit made clear that in order to sustain a limit below 60 percent (assuming the validity of the 40 percent open field premise), the government must establish a record of substantial evidence showing the existence or likelihood of anti-competitive actions by a large MSO acting individually or by multiple MSOs acting collusively in the MVPD market.

51. In the discussion that follows, we first present a more general version of the open field approach, which underlies our current rules. We seek to determine whether such a regulatory approach is still appropriate, and whether it can satisfactorily address the issues raised in the *Time Warner* decision. We then consider an approach designed to take into account the current market structure and performance of the industry. The overriding concern in these proposals is to ensure that alternative conduits for the delivery of multi-channel video programming to consumers remain viable. We also invite commenters to suggest alternative regulatory approaches.

C. Horizontal Limit Proposals

1. Limit Based on Market Share Measurements

52. **<u>Open Field Approach:</u>** One method of limiting horizontal concentration is to restrict the possible market share of cable MSOs, which is the basis of the Commission's current horizontal limit. The Commission's limit is designed to preserve at least four MSOs in the MVPD market and thereby ensure that MSOs individually or jointly do not defeat the entry of new programming networks. The limit bars any one MSO from serving more than 30 percent of MVPD subscribers, and effectively bars the two largest MSOs from serving more than 60 percent of MVPD subscribers. It is premised upon the

[116] *Id.* at 1132, 1133-34.

[117] *Id.* at 1134.

[118] *Id.*

[119] *Id*.

[120] *Id.* at 1131-32.

[121] *Id.* at 1134.

Commission's belief that a new programming network needs to reach approximately 20 percent of the 80 million MVPD subscribers in order to succeed. The limit is further premised on the theory that a network has a 50 percent chance of obtaining subscribers on systems that are not actively denied to it. Thus, the network needs to have access to MVPDs serving at least 40 percent of all MVPD subscribers to ensure that it will actually reach the necessary 20 percent of viewers. As discussed previously, the D.C. Circuit in *Time Warner* found that the Commission "is on solid ground in asserting authority to be sure that no single company could be in a position single handedly to deal a programmer a death blow," which would support a 60 percent cap, provided the Commission could substantiate its 40 percent open field premise.[122]

53. Some support for the 40 percent open field premise is found in the Federal Trade Commission's decision in the Time Warner-Turner Broadcasting System merger. Explaining its decision to place conditions on the merger, the FTC concluded that "because of the economies of scale involved, the launch of any significant new channel usually requires distribution on MVPDs that cover 40-60% of subscribers."[123] The FTC also found that there were "formidable entry barriers into content" and that entry into the market for "marquee" content "has proven slow and costly."[124] This finding would tend to support this Commission's open field formulation, at least for the purposes of protecting entry for general-audience programming. It is important to note, however, that the FTC decision was reached in 1997, when both MVPD competition and channel capacity were at lower levels than today.

54. In reexamining the horizontal limit, we recognize that different types of networks might need more or less than a 40 percent "open field" to survive, and that in the competition between networks of the same type a widely distributed network will have very significant advantages over a network with more limited distribution.[125] Although the costs of program production and distribution are not affected by the number of subscribers served once the initial investment in producing a program is made,[126] the necessary subscribership reach for success varies depending on the type of programming network.[127] In addition, for some types of programming networks, particularly high-cost networks,[128] advertising revenue may be critical. For these types of networks, the inability to reach large numbers of subscribers due to cable horizontal concentration could drive programmers out of business, deter entry, or reduce the quality and innovation of programming produced. The current 40 percent open field was intended to support the typical high-cost programming network that requires large audiences.

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[122] 240 F.3d at 1131-32.

[123] *In re Time Warner, Inc.*, 123 F.T.C. 171, 207 (1997) (statement of Chairman Robert Pitofsky and Commissioners Janet D. Steiger and Christine A. Varney) ("*FTC Time Warner Decision*").

[124] Rubenfeld, Daniel L. and Hal J. Singer, "Open Access to Broadband Networks: A Case Study of the AOL/Time Warner Merger," *UC Berkeley School of Law Public Law and Legal Theory Working Paper Series, No. 54* (2000), at 643-44 (quoting *FTC Time Warner Decision*, in discussing attempts to compete against cable programming by creating "marquee" video streaming content for transmission over the Internet).

[125] For a discussion of different types of networks and their geographic markets, *see* ¶¶ 12-13, *supra.*

[126] The average fixed costs of producing a program, *i.e.,* total fixed cost divided by number of entities buying the programming, however, declines when there are a larger number of networks and MSOs buying the programming. In other words, the fixed costs of producing programming are shared by a larger number of entities.

[127] For example, high-cost, broader-based networks need to reach more subscribers than more specialized niche networks.

[128] This group includes broad-based networks such as USA Networks and TNT, which attempt to reach mass audiences, and likely have high costs.

55. The D.C. Circuit opinion suggests that the Commission could adopt an open field limit of less than 60 percent if it could demonstrate the non-conjectural potential for anti-competitive harm.[129] We thus seek comment on whether the 30 percent horizontal ownership limit, or any other limit based on the open field, is justified in order to address and deter likely joint, anti-competitive actions of two or more large MSOs, or anti-competitive actions of a single MSO acting independently. The limit previously adopted by the Commission was premised on the statutory instruction to protect against impediments to the flow of programming resulting from the conduct of a cable operator or "group of cable operators" and on the Commission's belief that joint conduct would be more likely if there were only a limited number of operators in the market. In this regard, the Commission noted that there were economic benefits that operators could gain from coordinating their program purchasing activities and that those benefits create incentives for acting jointly.[130] Some types of coordination among cable system operators with respect to programming seem to have been common in the industry.[131] Most favored nation and other types of contractual provisions might also result in communication regarding programming purchases and incentives to coordinate programming acquisition activities. The D.C. Circuit, however, found that none of the Commission's prior assertions in this regard were supported in the record.[132]

56. Accordingly, we seek comment and economic evidence that would support or refute the Commission's earlier conclusions. Specifically, we seek information on the types of coordinated or collusive conduct among cable operators that might be relevant to the establishment of a limit. We seek comment, and empirical evidence, on whether vertically integrated MSOs have incentives to reach carriage decisions that are mutually beneficial, in terms of purchasing programming from one another or carrying the same networks, to reduce costs.[133] We seek comment on whether these existing activities fall within or outside the court's interpretation of collusion, or point to collusive behavior, or actually constitute collusion. Alternatively, we seek comment on comparable activities in other industries that share similar attributes, such as partial vertical integration. Absent such evidence of joint, collusive action, we seek comment, empirical evidence, or theories that might provide a basis for any particular limit based on the open field approach. Commenters should address whether such a limit can be justified in order to constrain the ability of a single large MSO to determine unilaterally the success or failure of a programming network through anti-competitive actions.

57. Further, the D.C. Circuit in *Time Warner* noted the "possibility that there are theories of anti-competitive behavior other than collusion that may be relevant to the horizontal limit and on which the FCC may be able to rely on remand."[134] We present above possible harms that arise from high levels of horizontal concentration.[135] We seek comment on these possible harms, and any other possible harms,

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[129] 240 F.3d at 1133-34.

[130] *1999 Horizontal Order*, 14 FCC Rcd 19098 at ¶ 43.

[131] An indication of the nature of joint ownership in the 1990 time frame is set forth in the Commission's *Report* in Docket 89-600, 5 FCC Rcd 4962 (1990) at Appendix G, Table VII. The Commission's annual video competition reports, starting with the 1994 *Report* in Docket 94-48, 9 FCC Rcd 7442 (1994), continue to trace these relationships.

[132] *See Time Warner*, 240 F.3d at 1132, 1135.

[133] *Id.*

[134] *Time Warner*, 240 F.3d at 1133.

[135] *See* ¶¶ 28-35, *supra*.

including those that result from anti-competitive behavior that may arise from a highly concentrated MVPD market.

58. We seek evidence and comment that could address the D.C. Circuit's concerns, as expressed in *Time Warner*, and thus support a strict subscribership percentage limit as a protection against excessive horizontal concentration. We are particularly interested in comment and empirical evidence that would support or contradict the 40 percent open field premise. At what level of concentration does a large cable operator gain the market power necessary to refuse carriage of programming for reasons other than consumer demand? Does the 40 percent open field gauge remain a valid estimate for the typical programming network's needs and, if not, what represents an appropriate alternative level? For instance, given a more established programming market, is a 40 percent open field still an appropriate level to allow new entrants to compete against established networks? In this regard, commenters are asked to submit empirical evidence that would address the level of subscribership necessary to sustain each of the various types of video programming networks described above. In such a discussion, commenters should address whether the statute requires protection of entry for all types of programming networks. We seek comment and empirical evidence on the availability of non-cable MVPD outlets for such programming and the effect of such outlets on the open field limit. Additionally, we seek evidence on the nature of the supply curve faced by cable operators in the market for the purchase of cable programming. We request commenters to address how an open field limit could be crafted to adequately address elasticities of supply and demand, and take into account market power, rather than just measure market presence or share. We also ask commenters to address whether the Commission should consider a more stringent reporting requirement than that currently set forth in Section 76.503(g)[136] for purposes of monitoring cable ownership levels.

59. Finally, we seek comment in response to this discussion, and in response to the discussion below, with regard to how issues of diversity are properly weighed in our analysis. The court previously upheld the statute, thus sustaining it against constitutional challenge based on the governmental interests in promoting both competition and diversity. The *Time Warner* decision, however, indicates that the statement of purpose in Section 613(f) "supports a reading that sharply confines the authority to regulate solely in the interest of diversity."[137] Nevertheless, the statute's enumerated objectives are not exclusive since they are listed as "among other public interest objectives."[138] The court does suggest that diversity, while not the primary concern of the statute, is a factor entitled to consideration. Accordingly, we ask commenters to address how diversity concerns, as well as other public interest concerns, can be properly factored into the determination of our rules.

2. Limit Based on Market Power Measurements

60. **<u>Threshold/Safe Harbor Approach:</u>** Another possible approach to guard against the harms of excessive horizontal concentration is to measure cable MSOs' market power within the MVPD industry using something other than an MSO's market share, and base ownership limits on such a measure. We note that market share, which is the premise of the open field approach, is one potential measure of market power. Here we seek comment on other ways to measure market power and craft a horizontal cable ownership limit. Competition in the MVPD market can limit cable MSOs' market power

[136] *See* n. 99, *supra*.

[137] *Time Warner*, 240 F.3d at 1136.

[138] Section 613(f)(2).

vis-à-vis video programming networks. Therefore, the imposition and enforcement of cable ownership limits can be conditioned on market conditions and thereby address the harms that Congress sought to prevent. The purpose of Section 613(f) is "to enhance effective competition," and the legislative history, discussed above,[139] indicates a preference for competition over regulation. The *Time Warner* decision directs the Commission to take into account the presence and effect of competitors to cable in that an MVPD's market power "depends not only on its share of the market, but also on the elasticities of supply and demand, which in turn are determined by the *availability of competition.*"[140] The value of a regulation that uses measures of market power is that it could be specifically tailored to the harms Congress sought to prevent. Such regulation, if practical to implement, would be more sophisticated than market share measures in that it would target directly the source of the potential harm: the cable industry's control over programmers' access to the home. This approach also would conform to the intent of Congress as expressed in the statute to prefer competition over regulation and with the opinion of the court in *Time Warner.*

61. To implement such an approach, we would have to: (1) establish a way of measuring market power within the MVPD industry; (2) determine the level of competition, taking into account market power in the industry and congressional intent, that would be needed to reach the level deemed effective competition; (3) determine the levels of market power that create the harms Congress sought to prevent; and (4) decide what action would be needed if those levels were met, or not met. Such a measure of market power could examine concentration within the industry and factors that might perpetuate this concentration, and market performance. The level of market power that causes harm would depend on empirical evidence or sound economic theory. If we found evidence that cable operators possess market power that causes significant harm, we could impose appropriate ownership limits until market power diminishes sufficiently. At that point, we could monitor the industry for the re-emergence of market power, or we could set thresholds that would trigger the imposition of regulation or enhanced scrutiny.

62. There may be several ways to measure effective competition and market power in this context. The appropriateness of using a particular standard may depend on the circumstances involved. We invite comment on the appropriate measure of competition, drawing from those suggested below or any other supported by sound economic theory. Because market power can influence market performance,[141] measures of market power often refer explicitly to performance. The two most commonly used measures of market performance are the Implicit Lerner Index[142] and the "q" ratio.[143] We seek comment on the relevance of such indicia as indicators of market power.

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[139] *See* ¶ 4, *supra*.

[140] *Time Warner*, 240 F.3d at 1134.

[141] We define market performance as the extent to which a given market satisfies consumer demand in the least costly manner taking into account the price and quality of the products under consideration.

[142] The Implicit Lerner Index measures the divergence between price and marginal cost which may result from the exercise of market power. For a further explanation, *see* Greer, Douglas F., *Industrial Organization and Public Policy*, Macmillan Publishing Company, 1984, at 48-50.

[143] The q ratio is the ratio of the market value of a firm, as measured by the market value of its outstanding stock and debt, to the replacement cost of the firm's physical assets. If the market value of a firm exceeds its replacement cost, this may be an indicator that excess economic profits are being earned. Although there are significant measurement problems associated with applying the q ratio, it is a potentially useful measure of market power. For a further explanation, *see Rate Deregulation and the Commission's Policies Relating to the Provision of Cable Television Services, Report on Competition,* 5 FCC Rcd at 4963, Appendix E (1990) ("*1990 Competition Report*").

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63. We also invite comment on the use of the level of concentration in the distribution market as a proxy for a measure of market power in the video programming market. More specifically, we seek comment on the use of the Herfindahl-Hirschman Index ("HHI") in this regard.[144] The Commission has used HHI calculations previously to assess concentration in the MVPD market at the national level.[145] HHI calculations in this context may be misleading or inappropriate because they measure horizontal concentration at a national level and are designed for application to industries where participants compete directly. In the MVPD market, however, the markets are local and cable MSOs rarely compete against each other in individual local markets.[146] The Commission has previously observed, however, that MSOs have primarily derived their ability to take anti-competitive action against programming services or competing MVPDs from their ability to leverage local market power on an intermarket basis (i.e., their local market power is derived partially from their national size).[147] We invite comment on the appropriateness of the use of HHI calculations or other such specific measures of competition in the national market.

64. One method of implementing a regulation that takes into account market power is to determine the level of competition necessary to prevent the harms envisioned by Congress. At that level, we could establish a "threshold" or "safe harbor" for regulation. Under a threshold regulation, we would not enforce horizontal limits provided there were, in addition to cable, alternative means for video programmers to reach consumers sufficient to alleviate the concerns that motivated Congress to adopt Section 613(f). The establishment of a threshold or safe harbor may serve to prevent the levels of concentration that would enable a single cable MSO to determine the success or failure of video programming networks. Thus, for example, we might not restrict the horizontal reach of a cable operator so long as additional MVPDs imposed sufficient competitive pressure on the cable operator in both the market for the purchase of programming (the upstream market) and in the distribution of programming (the downstream market). Implementing such a threshold would depend critically, however, on identifying the level at which alternative MVPDs protect consumers by reducing cable operators' market power to the point where they cannot expropriate programmers, or choose programming for reasons other than quality. A second consideration is the economic viability of smaller competitors: we would seek to set a limit that prevents large cable MSOs from disadvantaging smaller rival alternative MVPDs anti-competitively.

65. Although there are many buyers of programming (many separate cable MSOs, two DBS operators, many smaller MVPDs, and broadcast outlets) and many sellers of programming (program producers, packagers, cable networks), the major cable MSOs do not currently compete with each other in the downstream market for program distribution. It appears that alternative providers, to satisfy a threshold, whatever form that threshold might take, should compete in both upstream and downstream markets. Entities competing in the same local distribution (downstream) market have a clear incentive to

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Also see Hazlett, Thomas W. and Matthew L. Spitzer, *Public Policy Toward Cable Television*, MIT Press and AEI Press, 1997, at 21-6.

[144] The HHI is a measure of concentration that is calculated by summing the squared market shares of all sellers in the market. It takes into account the number of firms in the market and the degree of inequality among firms' market shares. For further explanation, *see 2000 Competition Report* at n. 628.

[145] *See Seventh Annual Report*, 16 FCC Rcd at 6077.

[146] *See e.g., Waterman and Weiss* at 154.

[147] *See 1990 Competition Report* at 5006.

compete for the acquisition of programming in the upstream market, whereas MVPDs not competing with each other in the same local distribution markets may not have such an incentive.[148] We seek comment on the necessary level of competition in the MVPD market that would constrain MSOs' ability to exert market power in the upstream market for program purchasing.

66. DBS operators compete with cable operators both in local distribution markets as well as in the market for the purchase of programming. In view of the possibility that, from the point of view of programming networks, carriage on DBS may not be a complete substitute to cable carriage, we seek comment on whether DBS can provide a constraint on cable's market power in the market for the purchase of programming. We also seek comment on whether DBS can provide a constraint on cable's market power in the markets for the delivery of programming.[149] Indeed, it appears that DBS currently is the only competitor with the subscriber reach and penetration that might satisfy the requirements of a meaningful threshold standard.[150] As a result, a threshold regulation may ultimately suggest a cross-ownership restriction between cable and DBS. In this regard, we note that Section 613(c) authorizes the Commission to "prescribe rules with respect to the ownership or control of cable systems by persons who own or control other media of mass communications which serve the same community served by a cable system."[151] The *Senate Report* contained a provision that would have required the Commission to impose a cable/DBS cross-ownership restriction when 10 percent of the nation receives some form of direct broadcast satellite service, in order "to further diversity and prevent cable from warehousing its potential competition."[152] However, the *Conference Report* deleted this provision, stating:

> In view of the fact that there are no DBS systems operating in the United States at this time, it would be premature to require the adoption of limitations now. However, the conferees expect the Commission to exercise its existing authority [under Section 613(c)]

[148] When entities compete in the downstream market, i.e., for MVPD subscribers, they have an incentive to try to offer the highest quality programming possible. If they do not (*e.g.*, if they choose programming based on affiliation rather than consumer demand), some of their subscribers may switch to competing MVPDs and, as a result, their revenues would fall. If MVPDs do not compete downstream (*e.g.*, separate cable operators in non-overlapping franchise areas), they may not have an incentive to compete in their purchase of programming and, in fact, may have an incentive to collude. Through such collusion, non-competing MVPDs may have increased bargaining power with programming networks and, as a result, gain more favorable pricing in the acquisition of programming. This possibility does not imply that collusion will result in all situations. The likelihood of successful collusion, however, may be reduced when entities compete in the downstream market. Substantial competition in both upstream and downstream markets, thus may reduce the likelihood of collusion or other anti-competitive practices, and thereby reduce the need for extensive regulatory intervention.

[149] *See Time Warner*, 240 F.3d at 1134.

[150] We have previously attempted to encourage this kind of head-to-head competition in the *1999 Horizontal Order* (*see* 14 FCC Rcd at 19110-12). Cable operators appear to be well positioned to overbuild neighboring markets, and this type of competition would satisfy our threshold approach. Such behavior is seldom observed in the cable industry, indicating that it may not be economically viable to overbuild. We therefore assume that non-cable competitors are the primary source of this type of head-to-head competition.

[151] 47 U.S.C. § 533(c).

[152] *Senate Report* at 47, 81.

> to adopt such limitations should it be determined that such limitations would serve the public interest.[153]

67. In a pending rulemaking proceeding, the Commission has sought comment on whether to adopt a cable/DBS cross-ownership restriction.[154] Specifically, the Commission sought comment on, among other things, whether to adopt a DBS ownership and cable cross-ownership restrictions or consider competition concerns on a case by case basis.[155] Most commenters suggested that there was no need to adopt specific ownership or cross-ownership rules, and that, at most, it might be appropriate to address such issues in the context of any specific merger or acquisition transactions.[156] Only a small number of commenters favored the adoption of specific ownership rules.[157]

68. We also note that the Commission has examined the issue of cross-ownership in the context of specific transfer application reviews.[158] In addition, in May 1998, the Antitrust Division filed an antitrust suit to prevent PrimeStar, Inc. (a company providing medium power satellite video services and owned by five of the largest cable MSOs), from acquiring the DBS assets of News Corp and MCI.[159] In October 1998, PrimeStar abandoned its plan to acquire those satellite assets.[160] Because the MVPD market has changed significantly since 1998, we seek further comment on a restriction on cable/DBS cross-ownership as it may relate to the adoption of a threshold/safe harbor limit on cable horizontal ownership.

69. *Threshold Implementation Issues.* In formulating a rule for a threshold regulation, we would not enforce horizontal limits, or presume public interest harm in this area in license transfer reviews, so long as an entity or entities, meeting certain criteria, competes in both the upstream and downstream markets. We would have to determine an appropriate measure for effective competition in

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[153] *Cable Television Consumer Protection and Competition Act of 1992*, 102d Cong., 2d Sess. Conference Report 102-862, 82 (1992) ("*Conference Report")*.

[154] *See In re Policies and Rules for the Direct Broadcast Satellite Service,* Notice of Proposed Rulemaking, IB Docket No. 98-21, 13 FCC Rcd 6907, 6937-42 (1998).

[155] *Id.* at 6939.

[156] Comments of Ameritech at 4; Comments of BellSouth at 3-5; Comments of DirecTV at 3-4; Comments of News Corp at 2-5; Comments of National Cable Television Association at 3-8; Comments of PrimeStar at 3-17; Comments of Tempo Satellite, Inc. at 7-8; Comments of Time Warner at 2-12; Comments of USSB at 7-8; Comments of the United Church of Christ and Consumers Union at 3; Reply Comments of News Corp. at 1-5; Reply Comments of PanAmSat at 2; Reply Comments of Primestar at 2-4; Reply Comments of Small Cable Business Association at 2-10; Reply Comments of Tempo at 3; Reply Comments of Time Warner at 1-11; Reply Comments of USSB at 2-6.

[157] Comments of EchoStar at 3; Comments of NRTC at 3-8; Comments of Univision at 2-8; Reply Comments of Univision at 2-6.

[158] *See, e.g*., *Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations by Time Warner Inc., and America Online, Inc.,* CS Docket No. 00-30, Memorandum Opinion and Order ¶¶ 241-51 (Jan. 22, 2001).

[159] *See U.S. v. Primestar, Inc., et al.* (May 12, 1998).

[160] U.S. Department of Justice, "Joel Klein Statement Regarding Primestar Abandoning Deal to Acquire News Corp./MCI's Direct Broadcast Satellite Assets," News Release (Oct. 14, 1998).

this context, and the level at which we would set a threshold according to that measure.[161] We invite empirically supported suggestions for any such formulation. An important issue is how to measure the presence of effective competition that will guard against harm. The "contestable markets" literature suggests that even monopolists may behave competitively if they face the threat of swift entry by effective competitors whenever the monopolist raises prices above cost or reduces product quality. Thus, potential competition may, in principle, constrain market power as effectively as actual competition. Some economic studies, on the other hand, link the extent of effective competition to the number of competitors in the market. One study, for example, suggests that at least three competitors are necessary in most cases to produce competitive outcomes and reduce the possibility of collusion.[162] In addition, the possibility of "swift entry" is not available in the MVPD industry because it takes years to build MVPD delivery systems. We invite comment on practical ways to measure when sufficient pressure exists to prevent large cable operators from exercising undue market power to the detriment of consumers. In particular, we seek comment on whether the number and/or size of competitors can serve as reasonably accurate measures of such pressure.

70. Thus, in implementing a threshold, we would have to determine whether a single competing service would be sufficient, or if we should require multiple competing services to meet the threshold. Additionally, we would have to determine what level of service would qualify to count toward the threshold. Accordingly, we seek comment on whether it would be appropriate to define a minimum channel capacity for any alternative MVPD to be counted toward the threshold. One possible minimum would be at least the average number of channels for a cable operator as shown in the *2000 Price Survey*.[163]

71. With regard to the enforcement of a threshold limit, we seek comment on the appropriate regulatory response to a finding that the threshold currently is not satisfied, or is met and subsequently not satisfied due to changed market conditions. One approach, embodied in our current rule, would be to prohibit cable operators from serving more than a specified percentage of cable or MVPD subscribers nationwide until the threshold has been met. Alternatively, instead of imposing a cap until the threshold is met, we could monitor the market for evidence of anti-competitive behavior by large cable operators. If we found behavior that was threatening or had the potential to threaten programmers' access to consumers, we could take action to impose horizontal limits at that time. Under this procedure, programmers could present evidence to the Commission that they are being denied access to subscribers unfairly and alternative MVPDs could present evidence that programming discounts offered to large cable operators are hurting their ability to act as alternative conduits of programming to consumers. We seek comment on whether a threshold limit would be appropriate and, if so, at what level we should set the limit. We also seek comment on whether such a limit could adequately take into account market power as opposed to simply measuring market share. In this regard, we request specific suggestions and empirical

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[161] For example, one possible threshold might be based on the "effective competition" benchmark established by the 1992 Act for local rate regulation. Under such a threshold, horizontal aggregation would not be constrained so long as competing MVPDs offer service to 50 percent of U.S. households and provide service, at a minimum, to 15 percent of MVPD subscribers.

[162] *See, e.g.*, John Kwoka, Jr., "The Effect of Market Share Distribution on Industry Performance," *The Review of Economics and Statistics,* Vol 61, 1979 at 101-9. Kwoka found the performance of three firms holding equal market shares in a concentrated industry similar to the performance of firms in a non-concentrated industry. Also, *see* Bresnahan, T.F. and P.C. Reiss, "Entry and Competition in Concentrated Markets," *Journal of Political Economy*, Vol 1991 at 977-1009.

[163] *See e.g., 2000 Price Survey* at 4346.

support to the extent possible. Additionally, we invite comment on the alternative approach of monitoring the market for evidence of anti-competitive behavior. We seek comment on whether this approach is appropriate and, if so, how such a monitoring process could be structured. Comments may include suggested rule formulations and methods of implementation. Finally, we ask commenters to address whether this approach comports with the Commission's statutory mandate in Section 613(f)(1)(A), 47 U.S.C. § 533(f)(1)(A), and further whether this approach represents a structural limit that will serve as a "prophylaxis" and obviate the need for individual determinations of anti-competitive behavior.[164]

72. The threshold approach appears to provide a means of tailoring regulation to fit the marketplace as it changes, and it would provide a degree of certainty to actors in the relevant markets. This approach also seems to respond to the court's instruction that we take into account the presence and effect of competitors to cable, while assuring that programmers have alternative means of access to consumers. Under this approach, so long as a sufficient level of effective competition was maintained, cable operators would not be constrained by an ownership limit. In addition, this approach would create a disincentive for large cable operators to attempt to act anti-competitively against DBS operators and other competitors.

73. *Potential Limitations to the Threshold Approach.* The threshold approach appears to address many of the harms Congress sought to prevent with Section 613(f). This approach would serve to ensure that there are always at least two or more MVPDs available to downstream subscribers and to upstream programming networks. In this context, even if a single MSO were to serve all cable subscribers, if the threshold were set appropriately, the alternative MVPDs would be large enough to constrain the single MSO's market power and also to provide a sufficiently large outlet to ensure the viability of programmers. We recognize, however, that the threshold limit may fail to meet congressional intent due to several potential problems. For example, if the threshold were set too low, either due to inaccurate measurement or due to changing market conditions, any of the potential problems due to excessive concentration noted above could occur.[165] We seek comment on whether it is realistic to condition our regulation on measurements of changing market power using measures of limited accuracy. Do these limitations suggest the need for more stringent regulation, such as a strict ownership limit? We also are aware of the possibility that larger MSOs might be willing to support the activities of weaker competitors at levels just above a threshold, thus avoiding regulation. We seek comment on this possibility, and on any means of preventing it.

V. VERTICAL LIMIT

A. The Commission's Vertical Rule

74. The Commission's channel occupancy limit generally prohibits a cable operator from carrying national video programming services it owns or in which it has an attributable interest on more than 40 percent of its activated channels.[166] In setting the vertical ownership limit at 40 percent, the

[164] *See Time Warner v. United States*, 211 F.3d at 1320, 1322-23; *see also* n. 7, *supra*.

[165] *See* ¶¶ 28-35, *supra*. These problems include limiting the supply of or entry into the market for programming, foreclosing competition, and the development of X-inefficiencies.

[166] 47 C.F.R. § 76.504 provides, in pertinent part:

(continued….)

Commission sought to "maximize the number of voices available to cable viewers without impairing the ability or incentive of cable operators to invest in new and existing video programming services."[167] The Commission recognized that, although Section 613(f) contemplated the establishment of some limits on cable vertical integration, "MSO investment was responsible for the development and survival of several of the most popular video programming services," and that "vertical integration among the largest MSOs had contributed to program diversity by providing new programming services with an extensive subscriber base and information regarding viewer tastes and desires."[168] The Commission also recognized that vertical integration can produce efficiencies with respect to video programming acquisition, distribution and marketing, which might contribute to innovative programming fare and lower subscription rates.[169] The Commission believed that the 40 percent limit was "high enough to preserve the benefits of vertical integration,"[170] and further relied upon the fact that most cable operators who filed comments in the rulemaking proceeding supported the 40 percent limit on that basis.[171]

75. Additionally, the Commission recognized that the need for a vertical limit would likely decrease as channel capacity increased. Thus, the Commission's rule establishes that the limit applies to channel capacity only "up to 75 channels."[172] As a result, for higher channel capacity systems, the percentage limit is actually much lower than 40 percent. By way of example, for a 200-channel system, 85 percent of the channels could be occupied by operator-affiliated programming. Moreover, because future expansion of channel capacity through the use of advanced technologies or the presence of effective competition might reduce or render unnecessary the 40%/75 channel limit, the Commission stated that it would revisit the restriction at a later date.[173]

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(a) Except as otherwise provided in this section no cable operator shall devote more than 40 percent of its activated channels to the carriage of national video programming services owned by the cable operator or in which the cable operator has an attributable interest.

(b) The channel occupancy limits set forth in paragraph (a) of this section shall apply only to channel capacity up to 75 channels.

In calculating a system's capacity, "activated channels" includes all commercial and non-commercial broadcast, PEG, and leased access channels carried. *See Second Report,* 8 FCC Rcd at 8588-89.

[167] *Id.* at 8592.

[168] *Id*. at 8584-85.

[169] *Id.* at 8594-95.

[170] *Id.* at 8592-93.

[171] *Id.*

[172] 47 C.F.R. § 76.504(b). The 75 channel threshold thus reserves at most 45 channels for unaffiliated programming services (75 x .60 = 45).

[173] In this regard, the Commission noted that it continued "to believe that expanded channel capacity will reduce the need for channel occupancy limits" and that "this limitation will be subject to periodic review . . . will be eliminated if developments warrant." *Second Report*, 8 FCC Rcd at 8601-02. Additionally, the Commission observed that "Congress has . . . indicated that a primary objective of the Act was to 'rely on the marketplace to the maximum extent feasible, to promote the availability to the public of a diversity of views and information' and that the legislation was intended to protect consumer interests in the receipt of cable service 'where cable television systems are not subject to effective competition.' Thus . . . further analysis as to whether the restrictions might be phased out

(continued.…)

B. The *Time Warner* Decision

76. The D.C. Circuit found that the Commission did not attempt to link the 40 percent numerical restriction with the benefits and harms resulting from common control of both programming supply and distribution sources or with current MVPD market conditions.[174] The D.C. Circuit dismissed the Commission's argument that "no MSO has yet complained that the 40 percent vertical limit has required it to alter programming." The court stated this was "no answer at all . . . [it] says nothing about the plans that the rule may have scuttled."[175] Concluding that the Commission neither justified the vertical limit with record support, nor established that the limit did not burden speech more than necessary, the D.C. Circuit reversed and remanded the limit. The court cautioned the Commission, on remand, to consider the constraining impact of competition on cable operators' ability to favor affiliated programming at the expense of unaffiliated programming, opining that competition "precludes cable operators from exercising the market power which originally justified channel occupancy limits."[176]

C. Current Market Conditions

77. The D.C. Circuit recognized that effective competition might "raise the stakes for a firm that sacrifices the optimal price-quality trade-off in its acquisition of programming" and thus constrain the "likelihood of improper favoritism of affiliated programmers" thereby justifying an exemption from the limits.[177] As previously discussed in the market description section, it appears that the competitive MVPD marketplace has evolved since the time the vertical limits were adopted, both locally and nationally, particularly as a result of DBS. Moreover, as discussed below, it seems that with increased channel

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where effective competition develops will be appropriate." *Id.* at 8603-04. In terms of effective competition, the Commission previously explained:

> Once effective competition has been established and a cable operator no longer occupies a program access bottleneck position, channel occupancy limits may no longer be necessary or desirable. With such developments, the incentive and ability of a cable system to favor its own programming over unaffiliated programming is diminished, and alternative outlets for programming should be available to the public.

Initial Notice, 8 FCC Rcd at 220. On reconsideration, the Commission affirmed the limit, finding no substantial objection to the prescribed limit had been raised by cable operators or cable programmers, but reaffirmed its commitment to reconsider the limit in light of future developments. *See 1995 Reconsideration Order*, 10 FCC Rcd at 7369, 7375, 7379.

[174] *Time Warner* at 1137-38.

[175] *Id.*

[176] *Id.* at 1138. The D.C. Circuit found plausible petitioners' argument that competition impacts cable operators' ability to favor in-house productions. The D.C. Circuit reasoned, "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." *Id.*

[177] *Time Warner*, 240 F.3d at 1139. With regard to possibly exempting cable operators that are subject to effective competition, the D.C. Circuit opined that "if the criteria of § 543(1)(1) [rate regulation definition of competition] are unsuitable, the Commission can consider concepts of effective that it finds more apt for these purposes." *Id*.

capacity and a trend away from cable ownership of programming, the landscape of the cable industry has undergone marked changes.[178]

78. In terms of capacity, cable operators, as well as other MVPDs, are continuing to upgrade and enhance system capabilities. These upgrades have enabled them to expand channel capacity and to add programming and other services through innovation. In the Commission's *2000 Competition Report*, we observed that:

> In October 1999, cable systems with capacity of 30 or more channels accounted for 85.4 percent of cable systems, or 8,236 systems. Cable systems with channel capacities of 54 channels or more accounted for 22.4 percent of cable systems in October 1999, or 2,164 systems. In addition, as of October 1999, 79 cable systems had a capacity of 91 or more channels. In October 2000, it was reported that cable systems with a capacity of 30 or more channels accounted for 86.6 percent of cable systems. This represents 8,032 systems nationwide. Systems with channel capacities of 54 channels or more accounted for 24.5 percent of cable systems in October 2000, or 2,247 systems. And as of October 2000, over 100 cable systems had a capacity of 91 or more channels.[179]

The above figures reference analog channels. With digital deployment, cable systems now are capable of offering subscribers hundreds of programming channels. Moreover, it seems likely that cable system capacity will continue to increase, offering consumers an abundance of video programming choices and services.

79. With respect to vertically integrated offerings, the Commission recently observed that, although the total number of programming networks has more than doubled between 1994 and September 2001 from 106 to approximately 285, the proportion of networks that were vertically integrated continued to decline.[180] Specifically, over the same period, the percentage of programming networks that were affiliated with at least one cable MSO declined from 53 percent to about 25 percent, a decline of 53 percent.[181] We seek comments on the ability of programming networks unaffiliated with cable operators to launch and survive in the industry as it stands today. Most helpful would be an historical analysis of the industry concerning the ability of new, independent networks to launch, remain independent, and survive, and that specifies the number that launched and failed or launched but subsequently became affiliated with cable operators.

80. We seek comments on how the changes in the MVPD market and in the level of vertical integration for cable MVPDs may have affected MSOs' ability to favor affiliated over unaffiliated programming. In addition, as discussed below, we also seek comment on how application of stringent

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[178] For example, 35% of all national programming networks were vertically integrated in 2000 compared to 53% in 1994. *Compare Seventh Annual Report,* 16 FCC Rcd at 6078-79 and *First Annual Report*, 9 FCC Rcd at 7522.

[179] *Seventh Annual Report,* 16 FCC Rcd at 6017-18 (internal citations omitted).

[180] *Id.* at 6078-79 (internal citations omitted). The September 20001 figure reflects AOL Time Warner's recent launch of four programming networks (@Max, 5 Starmax, OuterMax and W Max). Telephone interview with Laura Freeman, Assistant Manager for Corporate Affairs, AOL Time Warner (July 5, 2001)

[181] *Seventh Annual* Report, 16 FCC Rcd at 6078-70. The September 2001 figure reflects AT&T's recent spinoff of Liberty Media Inc. *See* http://www.libertymedia.com/our_affiliates/affiliates_main.htm.

vertical restrictions might impact economic efficiencies and affect cable operators' investment in, and production of, diverse and high quality programming.

D. Vertical Limit Proposals

81. Given the changes that have occurred in the MVPD industry generally and the cable industry specifically, as outlined above and in the market description section, we seek comment on how we could fashion meaningful and relevant channel occupancy limits. In this regard, we seek a better understanding of the economic underpinnings of the statutory requirement. We ask commenters to address the economic basis underlying the concern with vertical integration and market foreclosure. While both Congress and the Commission have long recognized that vertical integration produces efficiencies by enabling cable operators to make additional investments in programming,[182] they also were concerned that such integration may allow cable operators to engage in strategic, anti-competitive behavior.[183] Economic literature suggests that vertical integration between programmers and MVPDs can result in both market foreclosure (which can lead to higher prices) and efficiency gains (which tend to lower prices).[184] In order for vertical integration to have detrimental effects, two conditions must be satisfied. First, the vertically integrated MSO must have national monopsony power so that it could "significantly and profitably disadvantage a rival to its controlled downstream systems."[185] Second, the vertical integration must afford the MSO the means to implement such behavior (*i.e.*, but for vertical integration, the MSO would not be able to foreclose and disadvantage rival programmers).[186] We ask commenters to address whether such conditions exist in the industry, and if so, to discuss the implications thereof. Commenters should support their arguments with empirical evidence or theoretical justification. Moreover, although there is some evidence indicating that vertically integrated MSOs favor affiliated programming in terms of pricing, marketing, and carriage,[187] such behavior seems to diminish as channel capacity increases.[188] Indeed, it appears that as capacity expands, vertically integrated systems need to fill their channels and thus tend to increase the carriage of all networks, including those of rival, unaffiliated networks.[189]

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[182] *See Senate Report* at 25-27, 80; *House Report* at 41-43; *1995 Reconsideration Order*, 10 FCC Rcd at 7365-66; *Second Report*, 8 FCC Rcd at 8584-85; *Initial Notice*, 8 FCC Rcd at 218-19.

[183] *Id.*

[184] Chipty, Tasneem, "Vertical Integration, Market Foreclosure, and Consumer Welfare in the Cable Industry," *American Economic Review,* Vol 91 (3), June 2001, at 428-53. Using an econometric model of the cable industry, Chipty found that the harmful effects of integration due to foreclosure are offset by the efficiency-enhancing effects of integration.

[185] *Waterman and Weiss* at 56. Utilizing an economies-of-scale model, it has been suggested that an MSO "serving a quarter or less of all cable subscribers might exert monopsony control over cable networks" and thus satisfy the first condition. *Id.* at 65-66.

[186] *Id.* at 56-57.

[187] *Id.* at 88, 90-91, 94.

[188] *Id.* at 88-89.

[189] *Id.* at 93, 100-01.

82. Any tendency to favor affiliated programming may be further mitigated by the attendant benefits of economic efficiencies that flow from integration.[190] We ask commenters to address the implications of vertical integration and how these implications may affect the need for, or the formulation of, vertical restraints. We also ask commenters whether regulatory measures designed to curb foreclosure might better be addressed by measures designed to constrain anti-competitive behavior rather than by limits designed to restrict MSOs' ability to carry affiliated programming. If so, we seek comment as to how such alternative regulatory measures may be structured and how they would fit within the statutory scheme of Section 613(f). If commenters favor continuing channel occupancy limits, they should submit empirical evidence supporting the existing limits, or any alternative limit suggested.

83. We ask commenters to discuss whether and to what extent current and likely future developments in the MVPD market mitigate past concerns regarding the power of MSOs, individually or collectively, to discriminate against unaffiliated programming networks. In that regard, we ask commenters to address whether, consistent with the requirements of Section 613(f), the Commission may relax, exempt specific cable operators from, or even forgo imposing, vertical limits if the Commission determines that such a course of action would be justified given the prevailing market conditions. For example, we seek comment as to whether a decision to eliminate the vertical limit could be reconciled with the Commission's statutory mandate set forth in Section 613(f)(1)(B), 47 U.S.C. § 533(f)(1)(B). In addition, we seek comment as to the criteria the Commission should apply in determining whether to exempt a cable operator from the vertical limit if the Commission were to adopt an exemption. For instance, the D.C. Circuit directed that the Commission consider whether an exemption is justified where a cable operator is subject to effective competition.[191] We ask commenters to address the impact of effective competition on cable operators' ability to favor affiliated programming, and whether such competition would justify relaxing, exempting specific cable operators from, or eliminating the vertical limit.[192] We seek comment as to the factors the Commission should consider in defining effective competition for purpose of the vertical limit. Is the definition of effective competition which specifically applies for the purpose of rate regulation adequate or inadequate as a mark of real competition for these purposes? For example, are there certain subsections of U.S.C. § 543(l)(1) that are pertinent to defining effective competition and others that should be included for these purposes? Are there other criteria the Commission should consider? Moreover, mindful that Section 613(f)(2) requires the Commission to weigh the potential benefits and detriments of vertical integration, we ask commenters to address the implications of relaxing or eliminating the current 40%/75 channel limit.

84. Specifically, we ask commenters to address what impact, if any, the modification, the exemption from, or even possibly the elimination of the current limit might have on producing economic efficiencies, fostering innovation in services, and encouraging greater investment in and development of diverse and responsive programming. In this regard, we ask commenters to address what effect, if any, relaxation, the exemption from, or possibly the elimination of the channel occupancy limit would have on programming diversity, and what weight the Commission should accord those effects.[193] We further seek

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[190] *Id.* at 78. By contrast, Besen and Woodbury using data from TCI's carriage pattern conclude that TCI's carriage of affiliated services did not adversely affect the ability of non-affiliated services to compete. *See Besen and Woodbury* at 19.

[191] *See* 240 F.3d at 1138.

[192] *See Time Warner*, 240 F.3d at 1138.

[193] *Id.* at 1135 (holding that although Congress' primary objective underlying Section 613(f) was to promote competition, the Commission may consider, but not solely rely on, diversity concerns, in formulating limits).

comment on any detrimental effects that such course of action may have on the programming market in terms of potentially foreclosing the entry of new, independent programming networks, in today's evolving and dynamic MVPD marketplace. Additionally, consistent with Section 613(f)(2), we also ask commenters to address any additional public interest objectives the Commission should consider in reexamining its vertical limit. In addition, we seek comment on the possibility of fashioning a "process" rule rather than a fixed limit (*e.g.*, a rule that would place limits on a cable operator only after a finding that it had unfairly limited or foreclosed access), and if so, how such a rule should be crafted. We also encourage commenters to suggest alternative more relaxed, less stringent, limits than the Commission's current 40%/75 channel limit, supported by empirical evidence and taking into account the seven statutory, as well as any other relevant, public interest factors. Finally, we seek comment on what, if any, impact the leased access provisions may have on the possible modification, exemption from, or even elimination of the vertical restraint,[194] and what, if any, bearing the horizontal rules have on the need for vertical rules.

VI. ATTRIBUTION BENCHMARKS

A. The Commission's Cable Attribution Rules

85. The Commission's cable attribution benchmarks serve to identify ownership interests that enable owners or investors to exert influence or control over an entity's decisions. The benchmarks thus identify those interests that are deemed "attributable" and thereby implicated by the horizontal and vertical limits.[195] With the exception of the limited partner insulation criteria, the horizontal and vertical rules generally incorporate and utilize the benchmarks set forth in the Commission's general cable attribution rules.[196] The Commission adopted general cable benchmarks, based on the broadcast ownership rules, which attribute the interest of shareholders owning five percent or more voting stock.[197] The Commission further adopted the broadcast "single majority shareholder exemption," which exempted

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[194] The *Senate Report* noted that the 1992 Act was "largely designed to remedy market power in the cable industry. In this context, the leased access provision takes on added importance -- in addition to First Amendment concerns. It can act as a safety valve for programmers who may be subject to a cable operator's market power and who may be denied access or given access on unfavorable terms." *Senate Report* at 80.

[195] *See* 47 C.F.R. §§ 76.503 Note 2, 76.504 Note 1.

[196] *See* 47 C.F.R. §§ 76.501 Notes 1-5; *see also* 47 C.F.R. §§ 76.503 Note 2, 76.504 Note 1. There are a variety of attribution standards used in the Commission's rules, depending on the particular substantive rule and objective to be accomplished. In the cable area, there are two strains of attribution rules, the "general attribution standard," which the horizontal and vertical rules for the most part follow, and the so-called "program access attribution standard." For a detailed description of the Commission's general and specific cable attribution rules, *see 1999 Attribution Order*, 14 FCC Rcd at 19016-18, 19054-56. The *1999 Attribution Order* addressed both the general and program access standards. The D.C. Circuit only addressed: (1) the five and 33 percent general attribution benchmarks (which it upheld); and (2) the Commission's elimination of the majority shareholder exception and application of the limited partnership criterion that bars material involvement with video programming-related activities to preclude video programming sales (which it vacated). In this proceeding, we are only soliciting comment on the two aspects of the Commission's attribution rules that the D.C. Circuit vacated.

[197] *See* 47 C.F.R. § 76.501 Note 2(a); *see also Senate Report* at 80 (". . . it is the intent of the Committee that the FCC use the attribution criteria set forth in 73.3555 (notes) or other criteria the FCC may deem appropriate);" *Second Report*, 8 FCC Rcd at 8580-81, 8591-92 (concluding that the broadcast and cable attribution criteria serve the same objective, namely to identify ownership thresholds that impart the potential to influence or control an entity's programming or managerial decisions).

otherwise attributable minority voting interests from our general cable attribution rules where a single majority shareholder owned more than 50 percent of the corporation.[198] Moreover, as with the broadcast attribution benchmarks, interests of all limited partners, as well as officers and directors, are attributed under the general benchmarks unless their activities are unrelated to ("insulated" from) the cable entities' "media-related" activities.[199]

86. The Commission recently revised its general cable attribution benchmarks to attribute the interest of those who hold 33% or more of the cable entity's total assets ("equity plus debt"), including interests which otherwise would not be attributable (including non-voting and insulated interests).[200] And, as detailed below, the Commission also: (1) eliminated from the general attribution rules the single majority shareholder exemption, which was incorporated in the horizontal and vertical rules;[201] and (2) amended the horizontal and vertical rules to relax the limited partnership insulation criteria, by requiring that limited partners refrain from material involvement with the general partners' video programming-related -- rather than the broader media-related -- activities.[202]

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[198] The Commission found that the rationale underlying the 1984 adoption of the broadcast single majority shareholder exemption was appropriate and likewise applicable to cable. *See Second Report*, 8 FCC Rcd at 8580-81; *see also Corporate Ownership Reporting and Disclosure by Broadcast Licensees Amendment of Sections 73.35, 73.240 and 73.6363 of the Commission's Rules Relating to Multiple Ownership of Standard, FM and Television Broadcast Stations, Amendment of Sections 73.35, 73.240 and 76.501 of the Commission's Rules relating to Multiple Ownership of AM, FM, and Television Stations and CATV Systems, Reexamination of the Commission's Rules and Policies Regarding the Attribution of Ownership Interests in Broadcast, Cable Television and Newspaper Entities*, Report and Order, MM Docket nos. 20521, 20548, 78-239, and 83-46, 97 FCC 2d 997, 1008-09 (1984)("*1984 Broadcast Attribution Order*"). That rationale, as articulated in 1984, provided:

> In those instances where a corporate licensee, whether closely or widely-held, has a single majority voting shareholder, it appears neither necessary nor appropriate to attribute an interest to any other stockholder in the corporation. In these circumstances, the minority interest holders, even acting collaboratively, would be unable to direct the affairs or activities of the licensee on the basis of their shareholdings. These interests, therefore, will not be deemed cognizable for purposes of our multiple ownership rules. However, officers and directors of such licensee corporations will continue to have an attributable interest.

1984 Broadcast Attribution Order, 97 FCC 2d at 1008-09.

[199] *See* 47 C.F.R. §§ 76.501 Note 2 (a),(f)(1), (g); *see also* 47 C.F.R. §§ 73.3555 Note 2 (a), (g)(1), (h).

[200] *See 1999 Attribution Order*, 14 FCC Rcd at 19046-50 (addressing concerns that creditors and other investors with significant stakes have the incentive and the means to exert influence over cable entities' operations).

[201] In the *1999 Attribution Order*, the Commission eliminated the single minority shareholder exemption, which was set forth in 47 C.F.R. § 76.501 Note 2 (b) and provided "No minority voting stock interest will be cognizable if there is a single holder of more than 50% of the outstanding voting stock of the corporate broadcast licensee or cable television system in which the minority interest is held." *See 1999 Attribution Order*, 14 FCC Rcd at 19046.

[202] Specifically, the *1999 Attribution Order* amended the horizontal and vertical rules to relax the limited partnership insulation criteria. The revised insulation standard, which is narrower than the media-related insulation standards set forth in the Commission's general attribution rules at 47 C.F.R. § 76.501 Note 2 (f)(2), provides, in pertinent part, that "a limited partnership interest shall be attributed to a limited partner unless that partner is not materially involved, directly or indirectly, in the management or operation of the video-programming related activities of the partnership and the relevant entity so certifies." *See* 47 C.F.R. §§ 76.503 Note 2 (b)(1); Note 2 (b)(1); 76.504 Note 1(b)(a); *see also 1999 Attribution Order*, 14 FCC Rcd at 19040-41.

B. The *Time Warner* Decision

87. The D.C. Circuit examined "several aspects of the rules for attributing ownership for purposes of the horizontal and vertical limits."[203] The D.C. Circuit recognized that the attribution rules are designed to capture interests that impart the potential to influence, as well as control, a cable entity, and upheld the five percent voting and 33 percent equity plus debt benchmarks.[204] As discussed in greater detail below, however, the D.C. Circuit found that the Commission had not justified its elimination of the single majority-shareholder exemption or its application of the limited partnership insulation criteria to bar programming sales, and vacated those aspects of the attribution rules. We therefore ask commenters to address these two aspects of the cable attribution rules, and to provide us with empirical and/or theoretical evidence, including evidence from the cable industry or evidence based on studies of other industries, that support or contradict the Commission's prior conclusions. Also as discussed below, in light of the *Time Warner* decision, we seek evidence on whether to reinstate the single majority shareholder exemption for purposes of our broadcast and cable/multipoint distribution service (MDS)[205] attribution rules.

C. The "Single Majority Shareholder" Exemption

1. Cable Systems

88. As stated above, the D.C. Circuit found that the Commission had not justified elimination of the single majority shareholder exemption and thus vacated the Commission's repeal of it. The court characterized the Commission's elimination as a tightening of the regulations for which the Commission had offered no affirmative justification or finding regarding the potential for minority shareholder influence.[206] Therefore, while we recognize that the D.C. Circuit has reinstated the exemption, we must determine whether minority shareholders that would otherwise be attributable under our rules should be exempt where there is a single majority shareholder. One regulatory approach would be to review the individual ownership structures presented in particular situations, including the size and nature of the interests, the extent to which they are passive or active, and the economic incentives created in relation to the rules involved. In the past, however, the Commission has rejected such an approach because parties would not know in advance how specific interests might be treated and the Commission would need to undertake burdensome and intrusive inquiries into the details of corporate governance and influence. We continue to believe that, to the extent possible, bright line attribution standards are preferable to *ad hoc* evaluations, and seek comment on this conclusion.

89. In considering the status of the single majority shareholder exemption, we first note that because we eliminated the exemption at the same time we adopted the equity plus debt rule, we did not need to address to what extent the equity plus debt rule might limit the exemption. Now that the exemption is reinstated, however, the equity plus debt rule would limit application of the exemption as it does under our broadcast rules. Thus, for example, if a minority shareholder's financial interest in a cable operator amounts to over 33% of the operator's total asset value, the minority shareholder's interest would be attributable under the equity plus debt rule, even if the cable operator has a single majority

[203] *Time Warner*, 240 F.3d at 1139-40.

[204] *Id.* at 1140-42.

[205] MDS includes single channel multipoint distribution service and multichannel multipoint distribution service.

[206] *Id.* at 1143.

shareholder. In determining whether to eliminate the exemption, we must therefore consider the extent to which interests, not already covered by the equity plus debt rule, allow minority shareholders in a single majority shareholder corporation to exert influence.

90. While the Commission premised its adoption of the single majority shareholder exemption in 1984, on its conclusion that a minority interest shareholder would be unable to direct the affairs or activities of a licensee, our attribution rules are designed to identify not only interests that allow an entity to control a corporation, but also interests that give an entity the potential to exert influence over the licensee's core operations.[207] The elimination of the exemption reflected the Commission's view that influence could be asserted in several ways. For example, under general corporate law, directors and officers have certain fiduciary duties, which may make it necessary to be responsive to the interests of minority shareholders.[208] Minority shareholders that have contributed significant capital may have influence by virtue of the their ability to withdraw that investment. Minority shareholders may have access to confidential information. Management, although not legally obliged to do so, may feel a special responsibility to pay attention to the interests of significant, but not controlling, shareholders. Some of these considerations are akin to those considered by the Commission in conjunction with the equity plus debt rule.[209] In order to develop a record on the issue of the single majority shareholder exemption, we request comment on the mechanisms whereby such influences may be exerted and the extent of the influence likely to be involved. Is there a sound basis on which to conclude that a minority shareholder's influence over a corporation that has a single majority shareholder is so limited that the minority shareholder's interest should not be attributable under such circumstances? We are particularly interested in the extent to which significant minority shareholders lacking *de jure* control have a legal right to have their views considered by management and on the economic incentives majority owners have to give such minority shareholders an influential role. We also seek empirical evidence and/or theoretical models regarding the extent to which our concerns in this area already are addressed by the equity plus debt rule. If minority shareholders do have a degree of influence not covered by the equity plus debt rule, we ask commenters to discuss whether such influence is a matter that the rules should address and, if so, how these interests should be addressed under our rules.

2. Broadcast and Multipoint Distribution Service Industries

91. We also ask commenters to address whether the single majority shareholder exemption should be reinstated in the context of the broadcast and cable/MDS attribution rules.[210] The Commission

[207] *See 1999 Attribution Order,* 14 FCC Rcd at 19046 (expressing concern that a minority shareholder may be able to exert influence over a company even where a single majority shareholder exists).

[208] "[I]f the majority owner were to take actions that increased its profits at the expense of other investors in the system, the directors of the acquired system may be subject to shareholder suits for violating their fiduciary responsibilities to other shareholders. The threat of such suits may limit even the effective control of an investor with a majority interest." *See* Besen, Stanley A., Daniel P. O'Brien, John Woodbury, and Serge X. Moresi, *An Economic Analysis of the Effects of Partial Ownership Interests in Cable Systems*, Aug. 14, 1998, at 3, filed on behalf of AT&T in Docket 98-82.

[209] *See 1999 Attribution Order*, 14 FCC Rcd at 19046-51.

[210] Former Note 1(b) to Section 21.912 of the Commission's rules provided that "[n]o minority voting stock interest will be cognizable if there is a single holder of more than 50% of the outstanding voting stock of the corporate MDS licensee or cable television system in which the minority interest is held." 47 C.F.R. § 21.912 Note 1(b) (1999). Similarly, former Note 2(b) to Section 73.3555 provided that "[s]ubject to [the equity/debt plus rule], no minority voting interest will be cognizable if there is a single holder of more than 50% of the outstanding voting stock of the

(continued....)

recently amended its broadcast and cable/MDS attribution rules, but decided to retain the single majority shareholder exemption after seeking comment on whether to eliminate it.[211] Subsequently, on reconsideration,[212] the Commission granted a request to eliminate the single majority shareholder exemption, relying, in part, on its rationale for eliminating the exemption in the context of cable systems in its cable *1999 Attribution Order*, and further explaining that regardless of whether minority shareholder interests have the ability to control a licensee, they should be attributed because they potentially have the ability to exert influence over a licensee's core operations.[213] After the D.C. Circuit released its decision in *Time Warner*, we received three petitions for reconsideration and one set of comments supporting reconsideration of our decision to eliminate the single majority shareholder exemption in the context of the broadcast attribution rules.[214] We incorporate those petitions and comments by reference into the record in this proceeding. We further recognize that the *Time Warner* decision did not reinstate the single majority shareholder exemption for purposes of our broadcast and cable/MDS attribution rules. Given that the issues are related, however, we are separately issuing an order suspending enforcement of the elimination of the single majority shareholder exemption for the broadcast and MDS industries pending resolution of this proceeding.

92. In considering whether to reinstate the broadcast and cable/MDS single majority shareholder exemption, we invite comment on the same issues and questions raised with respect to the exemption as applied to cable systems.[215] We also invite comment as to whether there are differences, for purposes of attribution, between the broadcasting or MDS industries, and cable systems that would justify different

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corporate broadcast licensee, cable television system, or daily newspaper in which the minority interest is held." *Id*. § 73.3555 Note 2(b).

[211] *Review of the Commission's Regulations Governing Attribution of Broadcast and Cable/MDS Interests*, MM Docket No. 94-150, *Report and Order*, 14 FCC Rcd 12559, 12579, ¶ 36 (1999) ("*Broadcast Attribution R&O*").

[212] *Review of the Commission's Regulations Governing Attribution of Broadcast and Cable/MDS Interests*, MM Docket No. 94-150, Memorandum Opinion and Order on Reconsideration, 16 FCC Rcd 1097 (Jan. 19, 2001) ("*Broadcast Attribution MO&O*"). The *Broadcast Attribution MO&O* was published in the Federal Register on February 13, 2001, and the rule amendments became effective on April 16, 2001.

[213] *Broadcast Attribution MO&O*, 16 FCC Rcd at 1116-17, ¶¶ 41-44. In the *Broadcast Attribution MO&O*, the Commission noted that the rationale supporting adoption of the exemption in 1984, was based on the conclusion that minority interest shareholders would be unable to direct the licensee's affairs or activities. The Commission stated that "attribution rules are designed to identify not only interests that enable an entity to control a company, but also interests that give an entity the potential to exert significant influence on a company's major decisions, even if the entity cannot control the company. Minority shareholders may not be able to control the affairs or activities of licensees, but, in certain circumstances, they clearly have the potential to influence a licensee's actions." *Id*. at 1116, ¶ 43. The Commission found that eliminating the exemption for purposes of the broadcast and cable/MDS attribution rules would, therefore, improve the precision of the attribution rules in identifying cognizable interests. *Id*. at 1116, ¶ 42.

[214] The three petitioners are the National Broadcasting Company, Inc., Paxson Communications Corporation, and Viacom, Inc. The National Association of Broadcasters filed comments supporting the petitions. No oppositions were filed.

[215] *See supra* at ¶ 89. We note that while the "equity plus debt" rule limits the single majority shareholder exemption for cable systems, the "equity/debt plus" rule would limit the single majority shareholder exemption for the broadcast and MDS industries, if the exemption is reinstated. *See Broadcast Attribution R&O*, 14 FCC Rcd at 12579, ¶ 36, 12625, ¶ 152.

treatment with respect to this issue, or whether the industries are so similar that the treatment should be identical.[216]

D. The Insulated Limited Partnership Exception

93. The second aspect of our attribution rules vacated by *Time Warner*, and for which we seek comment, relates to the insulated limited partnership exception. As stated previously, under the rules, partnership interests are usually attributable unless "insulated."[217] The Commission's *1999 Attribution Order* relaxed the limited partnership standard for purposes of applying the horizontal and vertical rules to provide that a limited partner must not be materially involved in the general partner's "video programming-related activities," instead of the broader "media-related activities" standard found in the Commission's general attribution rules.[218] As amended, the horizontal and vertical rule afford a limited partner greater flexibility; it may insulate its partnership interest even if it participates in the partnership's other media activities so long as it is not materially involved in the partnership's video-programming related activities.[219] Thus, under the amended structural rules, a limited partnership interest is not attributed to a partner that is not directly or indirectly materially involved in the management or operation of the partnership's video programming-related activities and so certifies.[220]

94. Accordingly, for purposes of the horizontal and vertical limits, to be insulated, the limited partner may not engage in the following seven activities:

(1) act as an employee of the partnership if his or her functions, directly or indirectly, relate to the video programming enterprises of the company;

(2) serve, in any material capacity, as an independent contractor or agent with respect to the partnership's video programming enterprises;

(3) communicate with the licensee or general partners on matters pertaining to the day-to-day operations of its video programming business;

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[216] In the cable *1999 Attribution Order*, the Commission generally found no evidence that differences in ownership, financing, or management structures between the cable and broadcast industries warranted creating an attribution standard for applying the cable horizontal ownership, or other cable rules, that was different from the standard used in applying the broadcast multiple ownership rules. *Cable 1999 Attribution Order* at ¶ 33. As a result, the Commission saw no rational basis to distinguish between cable and broadcasting that would justify eliminating the exemption for the cable ownership rules while retaining it for the broadcast ownership rules. *Broadcast Attribution MO&O*, 16 FCC Rcd at 1116, ¶ 41.

[217] *See* 47 C.F.R. § 76.501(a); *see also* 47 C.F.R. §§ 76.503 Note 2; 76.504 Note 1.

[218] *1999 Attribution* Order, 14 FCC Rcd at 19040-42.

[219] *Id.* (finding that the broader media-related standard potentially could have captured interests relating to non-video programming activities, thwarting development of advanced services and technologies by discouraging investment and utilization of expertise in areas such as telephony or broadband).

[220] Specifically, the horizontal and vertical rules, as amended, provide explicitly state that an insulated limited partner shall not be "materially involved, directly or indirectly, in the management or operation of the video programming-related activities of the partnership." 47 C.F.R. §§ 76.503 Note 2 (b) (2); 76.504 Note 1 (b) (1).

(4) vote on the admission of additional general partners subject to the power of the general partner to veto any such admissions;

(5) vote to remove a general partner except where the general partner is subject to bankruptcy proceedings, is adjudicated incompetent by a court of competent jurisdiction, or is removed for cause as determined by a neutral arbiter;

(6) perform any services for the partnership materially relating to its video programming activities, except that a limited partner may make loans to or act as a surety for the business; and

(7) become actively involved in the management or operation of the video programming businesses of the partnership.[221]

Consistent with and in reliance upon *Twentieth Century Corp.*,[222] the Commission has interpreted the criterion that bars a limited partner from performing any service that materially relates to video programming activities as precluding the sale of video programming to the general partner cable entity.[223] The Commission reasoned that "given that a cable operator's core media activity is the provision of video programming, there can be no service more material to a cable operator's video programming than the sale of video programming to the cable operator."[224]

95. The D.C. Circuit found that the Commission "has drawn no connection between the sale of programming and the ability of a limited partner to control programming choices."[225] In this regard, the D.C. Circuit posited that:

> 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.[226]

96. The Commission's decision in *Twentieth Holdings Corp.* provides a useful illustration of how the "no material involvement" standard relates to the program purchasing issue.[227] Specifically, in *Twentieth Holdings Corp.*, the issue was whether a broadcast station owner could make its ownership non-attributable by placing the station in trust, while continuing to provide network programming to the station. The Commission held that it could not, finding that, since programming is at the heart of the station's operations, permitting communications as to programming would be a substantial breach of the concept of insulation.

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[221] *1999 Attribution Order*, 14 FCC Rcd at 19040-41.

[222] 4 FCC Rcd 4052 (1989).

[223] *See Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from MediaOne Group, Inc. to AT&T Corp*., 15 FCC Rcd 9816, 9839 (2000).

[224] *Id.*

[225] *Time Warner*, 240 F.3d at 1143.

[226] *Id.* (citations omitted).

[227] *See* n. 222, *supra.*

97. In this proceeding we seek comment on whether the concerns that the Commission articulated in *Twentieth Holdings Corp.* are relevant to the application of the cable attribution rules. At issue here is whether the sale of video programming constitutes direct or indirect material involvement with the general partner's video programming-related activities generally, and whether such sales are precluded by the "performance of service" criterion specifically. We ask commenters to submit empirical or theoretical evidence supporting or contradicting the Commission's conclusion that a limited partner's sale of video programming to the partnership imparts the potential to control or influence the partnership's acquisition of video programming. We ask commenters to address the D.C. Circuit's suggestion that the criteria barring communications pertaining to the video programming business is sufficient to ensure that a limited partner's status will not be able to influence or control the general partner's video programming-related activities generally, and its video programming acquisitions specifically. Finally, we ask commenters to address whether it is possible to apply the insulation criterion to allow the sale of video programming, and whether they still bar communications with the licensee or general partners on matters pertaining to the day-to-day operations of its video programming business.

VII. INITIAL REGULATORY FLEXIBILITY ANALYSIS

98. As required by the Regulatory Flexibility Act ("RFA"),[228] the Commission has prepared this Initial Regulatory Flexibility Analysis ("IRFA") of the possible significant economic impact on a substantial number of small entities by the policies and rules considered in this *Further Notice*. Written public comments are requested on this IRFA. Comments must be identified as responses to this IRFA and must be filed by the deadlines for comments on the *Further Notice* provided in paragraph 127 of this item. The Commission will send a copy of the *Further Notice*, including this IRFA, to the Chief Counsel for Advocacy of the Small Business Administration ("SBA").[229] In addition, the *Further Notice* and the IRFA (or summaries thereof) will be published in the Federal Register.[230]

A. Need for, and Objectives of, the Proposed Rules

99. Section 613(f) of the Communications Act is intended to encourage competition in the multichannel video programming distribution ("MVPD") market, and to prevent the exercise of undue market power by large cable operators, who own or have attributable interests in multiple cable systems. Specifically, Section 613(f) requires the Commission to establish reasonable limits on the number of cable subscribers that may be reached through commonly owned or attributed systems (horizontal limits) and on the number of channels that can be occupied by the cable system's owned or attributed video programming services (vertical limits). Pursuant to its statutory mandate, the Commission issued horizontal and vertical limits, and defined the attributable interests implicated by the limits. In *Time Warner Entertainment Co. v. FCC*, 240 F.3d 1126 (D.C. Cir. 2001), the D.C. Circuit remanded the Commission's horizontal and vertical limits, and vacated two aspects of the Commission's attribution rules. By this *Further Notice*, we seek comment on the Commission's rules affected by the *Time Warner* decision.

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[228] *See* 5 U.S.C. § 603. The RFA has been amended by the *Contract With America Advancement Act of 1996*, Pub. L. No. 104-121, 110 Stat. 847 (1996) ("CWAAA"). *See* 5 U.S.C. § 601 *et. seq*. Title II of the CWAAA is the *Small Business Regulatory Enforcement Fairness Act of 1996* ("SBREFA").

[229] *See* 5 U.S.C. § 603(a).

[230] *Id.*

100. In 1999, the Commission amended its broadcast and cable/MDS attribution rules, deciding to retain the single majority shareholder exemption after seeking comment on whether to eliminate it.[231] On reconsideration, the Commission granted a request to eliminate the single majority shareholder exemption, relying on its rationale for eliminating the exemption in the context of cable systems in its cable *1999 Attribution Order*, and further explaining that regardless of whether minority shareholder interests have the ability to control a licensee, they should be attributed because they potentially have the ability to exert influence over a licensee's core operations.[232] Because the Commission relied, in part, on the reasoning rejected in *Time Warner* to eliminate the single majority shareholder exemption under its broadcast and cable/MDS attribution rules, the *Further Notice* also seeks comment on whether to reinstate the exemption.

B. Legal Basis

101. The authority for the action proposed in this rulemaking is contained in Sections 2(a), 4(i), 303, 307, 309, 310, and 613 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 152(a), 154(i), 303, 307, 309, 310, 533.

C. Description and Estimate of the Number of Small Entities to Which the Proposed Rules Will Apply

102. The RFA directs agencies to provide a description of, and where feasible, an estimate of the number of small entities that may be affected by the proposed rules, if adopted.[233] The RFA generally defines the term "small entity" as having the same meaning as the terms "small business," "small organization," and "small governmental jurisdiction."[234] In addition, the term "small business" has the same meaning as the term "small business concern" under the Small Business Act.[235] A "small business concern" is one which: (1) is independently owned and operated; (2) is not dominant in its field of operation; and (3) satisfies any additional criteria established by the SBA.[236]

103. The SBA has developed a definition of small entities for cable and other pay television services, which includes all such companies generating $11 million or less in revenue annually.[237] This definition, among others, includes cable system operators, direct broadcast satellite services, multipoint

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[231] *Review of the Commission's Regulations Governing Attribution of Broadcast and Cable/MDS Interests*, MM Docket No. 94-150, *Report and Order*, 14 FCC Rcd 12559, 12579, ¶ 36 (1999) ("*Broadcast Attribution R&O*").

[232] *Review of the Commission's Regulations Governing Attribution of Broadcast and Cable/MDS Interests*, MM Docket No. 94-150, *Memorandum Opinion and Order on Reconsideration*, 16 FCC Rcd 1097, 1116-17, ¶¶ 41-44 (Jan. 19, 2001) ("*Broadcast Attribution MO&O*").

[233] 5 U.S.C. § 603(b)(3).

[234] 5 U.S.C. § 601(6).

[235] 5 U.S.C. § 601(3) (incorporating by reference the definition of "small business concern" in the Small Business Act, 15 U.S.C. § 632). Pursuant to 5 U.S.C. § 601(3), the statutory definition of a small business applies "unless an agency, after consultation with the Office of Advocacy of the Small Business Administration and after opportunity for public comment, establishes one or more definitions of such term which are appropriate to the activities of the agency and publishes such definition(s) in the Federal Register."

[236] 15 U.S.C. § 632.

[237] 13 C.F.R. § 121.201, North American Industry Classification System ("NAICS") Codes 51321 and 51322.

distribution services and satellite master antenna systems. According to the Census Bureau data from 1992, there were 1,788 total cable and other pay television services and 1,423 had less than $11 million in revenue.[238] We address below each service individually to provide a more precise estimate of small entities.

104. *Cable Systems*. The Commission has developed its own definition of a small cable system operator for the purposes of rate regulation. Under the Commission's rules, a "small cable company" is one serving fewer than 400,000 subscribers nationwide.[239] Based on our most recent information, we estimate that there were 1,439 cable operators that qualified as small cable system operators at the end of 1995.[240] Since then, some of those companies may have grown to serve over 400,000 subscribers, and others may have been involved in transactions that caused them to be combined with other cable operators. Consequently, we estimate that there are fewer than 1,439 small entity cable system operators that may be affected by the proposed rules.

105. The Communications Act of 1934, as amended, also contains a definition of a small cable system operator, which is "a cable operator that, directly or through an affiliate, serves in the aggregate fewer than 1 percent of all subscribers in the United States and is not affiliated with any entity or entities whose gross annual revenues in the aggregate exceed $250,000,000."[241] The Commission has determined that there are 67,700,000 subscribers in the United States.[242] Therefore, an operator serving fewer than 677,000 subscribers shall be deemed a small operator, if its annual revenues, when combined with the total annual revenues of all of its affiliates, do not exceed $250 million in the aggregate.[243] Based on available data, we estimate that the number of cable operators serving 677,000 subscribers or less totals approximately 1,450.[244] We do not request nor collect information on whether cable system operators are affiliated with entities whose gross annual revenues exceed $250,000,000,[245] and therefore are unable to estimate accurately the number of cable system operators that would qualify as small cable operators under the definition in the Communications Act.

106. *Direct Broadcast Satellite Service ("DBS")*: Because DBS provides subscription services, DBS falls within the SBA-recognized definition of "Cable and Other Pay Television

[238] *See U.S. Department of Commerce, Bureau of the Census, Industry and Enterprise Receipts Size Report,* Table 2D, NAICS Codes 51321 and 51322 (U.S. Bureau of the Census data under contract to the Office of Advocacy of the U.S. Small Business Administration).

[239] 47 C.F.R. § 76.901(e). The Commission developed this definition based on its determinations that a small cable system operator is one with annual revenues of $100 million or less. *Sixth Report and Order and Eleventh Order on Reconsideration*, MM Doc. Nos. 92-266 and 93-215, 10 FCC Rcd 7393 (1995).

[240] Paul Kagan Associates, Inc., Cable TV Investor, Feb. 29, 1996 (based on figures for Dec. 30, 1995).

[241] 47 U.S.C. § 543(m)(2).

[242] *See FCC Announces New Subscriber Count for the Definition of Small Cable Operator,* Public Notice DA 01-158 (January 24, 2001).

[243] 47 C.F.R. § 76.1403(b).

[244] Paul Kagan Associates, Inc., Cable TV Investor, Feb. 29, 1996 (based on figures for Dec. 30, 1995).

[245] We do receive such information on a case-by-case basis only if a cable operator appeals a local franchise authority's finding that the operator does not qualify as a small cable operator pursuant to section 76.1403(b) of the Commission's rules, 47 C.F.R. § 76.1403(b).

Services."[246] This definition provides that a small entity is one with $11 million or less in annual receipts.[247] There are four licensees of DBS services under Part 100 of the Commission's Rules. Three of those licensees are currently operational. Two of the licensees that are operational have annual revenues that may be in excess of the threshold for a small business.[248] The Commission, however, does not collect annual revenue data for DBS and, therefore, is unable to ascertain the number of small DBS licensees that could be impacted by these proposed rules. DBS service requires a great investment of capital for operation, and we acknowledge that there are entrants in this field that may not yet have generated $11 million in annual receipts, and therefore may be categorized as a small business, if independently owned and operated.

107. *Multipoint Distribution Service ("MDS"), Multichannel Multipoint Distribution Service ("MMDS") and Local Multipoint Distribution Service ("LMDS"):* MMDS systems, often referred to as "wireless cable," transmit video programming to subscribers using the microwave frequencies of the Multipoint Distribution Service ("MDS") and Instructional Television Fixed Service ("ITFS").[249] LMDS is a fixed broadband point-to-multipoint microwave service that provides for two-way video telecommunications.[250]

108. In connection with the 1996 MDS auction, the Commission defined small businesses as entities that had annual average gross revenues of less than $40 million in the previous three calendar years.[251] This definition of a small entity in the context of MDS auctions has been approved by the SBA.[252] The MDS auctions resulted in 67 successful bidders obtaining licensing opportunities for 493 BTAs. Of the 67 auction winners, 61 met the definition of a small business. MDS also includes licensees of stations authorized prior to the auction. As noted, the SBA has developed a definition of small entities for pay television services, which includes all such companies generating $11 million or less in annual receipts.[253] This definition includes multipoint distribution services, and thus applies to MDS licensees and wireless cable operators that did not participate in the MDS auction. Information available to us indicates that there are approximately 850 of these licensees and operators that do not generate revenue in excess of $11 million annually. Therefore, for purposes of the IRFA, we find there are approximately 850 small MDS providers as defined by the SBA and the Commission's auction rules.

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[246] 13 C.F.R. § 121.201, NAICS Codes 51321 and 51322.

[247] *Id.*

[248] *Id*.

[249] *Amendment of Parts 21 and 74 of the Commission's Rules with Regard to Filing Procedures in the Multipoint Distribution Service and in the Instructional Television Fixed Service and Implementation of Section 309(j) of the Communications Act – Competitive Bidding*, MM Docket No. 94-131 and PP Docket No. 93-253, Report and Order, 10 FCC Rcd at 9589, 9593 ¶ 7 (1995).

[250] *See Local Multipoint Distribution Service,* Second Report and Order, 12 FCC Rcd 12545 (1997).

[251] 47 C.F.R. § 21.961(b)(1).

[252] *See Amendment of Parts 21 and 74 of the Commission's Rules With Regard to Filing Procedures in the Multipoint Distribution Service and in the Instructional Television fixed Service and Implementation of Section 309(j) of the Communications Act – Competitive Bidding*, MM Docket No. 94-131 and PP Docket No. 93-253, Report and Order, 10 FCC Rcd 9589 (1995).

[253] 13 C.F.R. § 121.201, NAICS Codes 52321 and 52322.

109. The SBA definition of small entities for pay television services, which includes such companies generating $11 million in annual receipts, appears applicable to ITFS.[254] There are presently 2,032 ITFS licensees. All but 100 of these licenses are held by educational institutions. Educational institutions are included in the definition of a small business.[255] However, we do not collect annual revenue data for ITFS licensees, and are not able to ascertain how many of the 100 non-educational licensees would be categorized as small under the SBA definition. Thus, we tentatively conclude that at least 1,932 licensees are small businesses.

110. Additionally, the auction of the 1,030 LMDS licenses began on February 18, 1998 and closed on March 25, 1998. The Commission defined "small entity" for LMDS licenses as an entity that has average gross revenues of less than $40 million in the three previous calendar years.[256] An additional classification for "very small business" was added and is defined as an entity that, together with its affiliates, has average gross revenues of not more than $15 million for the preceding calendar years.[257] These regulations defining "small entity" in the context of LMDS auctions have been approved by the SBA.[258] There were 93 winning bidders that qualified as small entities in the LMDS auctions. A total of 93 small and very small business bidders won approximately 277 A Block licenses and 387 B Block licenses. On March 27, 1999, the Commission re-auctioned 161 licenses; there were 40 winning bidders. Based on this information, we conclude that the number of small LMDS licenses will include the 93 winning bidders in the first auction and the 40 winning bidders in the re-auction, for a total of 133 small entity LMDS providers as defined by the SBA and the Commission's auction rules.

111. In sum, there are approximately a total of 2,000 MDS/MMDS/LMDS stations currently licensed. Of the approximate total of 2,000 stations, we estimate that there are 1,595 MDS/MMDS/LMDS providers that are small businesses as deemed by the SBA and the Commission's auction rules.

112. *Satellite Master Antenna Television ("SMATV") Systems.* The SBA definition of small entities for "Cable and Other Pay Television Services" specifically includes SMATV services and, thus, small entities are defined as all such companies generating $11 million or less in annual receipts.[259] Industry sources estimate that approximately 5,200 SMATV operators were providing service as of December 1995.[260] Other estimates indicate that SMATV operators serve approximately 1.5 million residential subscribers as of June 2000.[261] The best available estimates indicate that the largest SMATV operators serve between 15,000 and 55,000 subscribers each. Most SMATV operators serve approximately 3,000 to 4,000 customers. Because these operators are not rate regulated, they are not

[254] *Id.*

[255] SBREFA also applies to nonprofit organizations and governmental organizations such as cities, counties, towns, townships, villages, school districts, or special districts, with populations of less than 50,000. 5 U.S.C. § 601(5).

[256] *See Local Multipoint Distribution Service,* Second Report and Order, 12 FCC Rcd 12545 (1997).

[257] *Id.*

[258] *See* Letter to Daniel Phythyon, Chief, Wireless Telecommunications Bureau (FCC) from A. Alvarez, Administrator, SBA (January 6, 1998).

[259] 13 C.F.R. § 121.201, NAICS Codes 51321 and 51322.

[260] *See Third Annual Report*, 12 FCC Rcd at 4403-4.

[261] *See Seventh Annual Report*, 16 FCC Rcd at 6048.

required to file financial data with the Commission. Furthermore, we are not aware of any privately published financial information regarding these operators. Based on the estimated number of operators and the estimated number of units served by the largest ten SMATVs, we believe that a substantial number of SMATV operators qualify as small entities.

113. *Open Video Systems*. Because OVS operators provide subscription services,[262] OVS falls within the SBA-recognized definition of "Cable and Other Pay Television Services."[263] This definition provides that a small entity is one with $11 million or less in annual receipts.[264] The Commission has certified approximately 25 OVS operators to serve 75 areas, and some of those are currently providing service.[265] Affiliates of Residential Communications Network, Inc. ("RCN") received approval to operate OVS systems in New York City, Boston, Washington, D.C. and other areas. RCN has sufficient revenues to assure us that they do not qualify as small business entities. Little financial information is available for the other entities authorized to provide OVS that are not yet operational. Given that other entities have been authorized to provide OVS service but have not yet begun to generate revenues, we conclude that at least some of the OVS operators qualify as small entities.[266]

114. *Program Producers and Distributors*. The Commission has not developed a definition of small entities applicable to producers or distributors of cable television programs. Therefore, we will use the SBA classifications of Motion Picture and Video Tape Production (NAICS Code 51211),[267] Motion Picture and Video Tape Distribution (NAICS Codes 42199, 51212),[268] and Theatrical Producers (Except Motion Pictures) and Miscellaneous Theatrical Services (NAICS Codes 56131, 71111, 71141, 561599, 71151, 71112, 71131, 71132, 51229, 53249).[269] These SBA definitions provide that a small entity in the cable television programming industry is an entity with $21.5 million or less in annual receipts for NAICS Codes 51211, 42199 and 51212, and $5 million or less in annual receipts for NAICS Codes 56131, 71111, 71141, 561599, 71151, 71112, 71131, 71132, 51229 and 53249.[270] Census Bureau data indicate the following: (a) there were 7,265 firms in the United States classified as Motion Picture and Video Production (NAICS Code 51211), and that 6,987 of these firms had $16.999 million or less in

[262] *See* 47 U.S.C. § 573.

[263] 13 C.F.R. § 121.201, NAICS Codes 51321 and 51322.

[264] *Id.*

[265] *See* http://www.fcc.gov/csb/ovs/csovscer.html.

[266] 13 C.F.R. § 121.201, NAICS Codes 51321 and 51322.

[267] Establishments primarily engaged in the production of theatrical and nontheatrical motion pictures and video tapes for exhibition or sale, including educational, industrial, and religious films. Included in the industry are establishments engaged in both production and distribution. Such producers of live radio and television programs are classified in NAICS Code 51211.

[268] Such establishments primarily engaged in the distribution (rental or sale) of theatrical and nontheatrical motion picture films or in the distribution of video tapes and disks, except to the general public. Motion pictures and video tape distribution are classified in NAICS Codes 42199 and 51212.

[269] Such establishments primarily engaged in providing live theatrical presentations, such as road companies and summer theaters, including producers of live television programs. Such producers of live theatrical presentation are classified in NAICS Codes 56131, 71111, 71141, 561599, 71151, 71112, 71131, 71132, 51229, and 53249.

[270] 13 C.F.R. § 121.201.

annual receipts and 7,002 of these firms had $24.999 million or less in annual receipts;[271] (b) there were 1,139 firms classified as Motion Picture and Video Tape Distribution (NAICS Codes 42199 and 51212), and 1,007 of these firms had $16.999 million or less in annual receipts and 1,013 of these firms had $24.999 million or less in annual receipts; and (c) there were 5,671 firms in the United States classified as Theatrical Producers and Services (NAICS Codes 56131, 71111, 71141, 561599, 71151, 71112, 71131, 71132, 51229, and 53249), and 5,627 of these firms had $4.999 million or less in annual receipts.[272]

115. Each of these NAICS categories is very broad and includes firms that may be engaged in various industries, including cable programming. Specific figures are not available regarding how many of these firms exclusively produce and/or distribute programming for cable television or how many are independently owned and operated. Thus, we estimate that our rules may affect approximately 6,987 small entities primarily engaged in the production and distribution of taped cable television programs and 5,627 small producers of live programs that may be affected by the rules adopted in this proceeding.

116. *Home Satellite Dish Service ("HSD")*: Because HSD provides subscription services, HSD falls within the SBA-recognized definition of "Cable and Other Pay Television Services."[273] This definition provides that a small entity is one with $11 million or less in annual receipts.[274] The market for HSD service is difficult to quantify. Indeed, the service itself bears little resemblance to other MVPDs. HSD owners have access to more than 265 channels of programming placed on C-band satellites by programmers for receipt and distribution by MVPDs, of which 115 channels are scrambled and approximately 150 are unscrambled.[275] HSD owners can watch unscrambled channels without paying a subscription fee. To receive scrambled channels, however, an HSD owner must purchase an integrated receiver-decoder from an equipment dealer and pay a subscription fee to an HSD programming package. Thus, HSD users include: (1) viewers who subscribe to a packaged programming service, which affords them access to most of the same programming provided to subscribers of other MVPDs; (2) viewers who receive only non-subscription programming; and (3) viewers who receive satellite programming services illegally without subscribing. Because scrambled packages of programming are most specifically intended for retail consumers, these are the services most relevant to this discussion.[276]

117. According to the most recently available information, there are approximately four program packagers nationwide offering packages of scrambled programming to retail consumers.[277]

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[271] U.S. Small Business Administration 1992 Economic Census Industry and Enterprise Report, Table 2D, NAICS 51211, (U.S. Bureau of the Census data adapted by the Office of Advocacy of the U.S. Small Business Administration) ("*SBA 1992 Census Report*"). Because the Census data do not include a category for $21.5 million, we have reported the closest increment below and above the $21.5 million threshold. There is a difference of 15 firms between the $16,999 and $24,999 million annual receipt categories. It is possible that these 15 firms could have annual receipts of $21.5 million or less and would therefore be classified as small businesses.

[272] 13 C.F.R. § 121.201, NAICS Codes 56131, 71111, 71141, 561599, 71151, 71112, 71131, 71132, 51229, and 53249.

[273] 13 C.F.F. § 121.201, NAICS Codes 51321 and 51322.

[274] *Id.*

[275] Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming, Third Annual Report, CS Docket No. 96-133, 12 FCC Rcd 4358, 4385 (1996) ("*Third Annual Report").*

[276] *Id.* at 4385.

[277] *Id.*

These program packagers provide subscriptions to approximately 1,476,700 subscribers nationwide.[278] This is an average of about 370,000 subscribers per program package. This is smaller than the 400,000 subscribers used in the commission's definition of a small MSO. It is likely that some program packagers may be substantially smaller.

118. *Radio and Television.* The SBA defines a radio station that has $5 million or less in annual receipts as a small business.[279] A radio broadcasting station is an establishment primarily engaged in broadcasting aural programs by radio to the public.[280] Included in this industry are commercial, religious, educational, and other radio stations.[281] Radio broadcasting stations, which primarily are engaged in radio broadcasting and which produce radio program materials, are similarly included.[282] Radio stations, however, that are separate establishments and are primarily engaged in producing radio program material are classified under another NAICS number.[283] As of June 30, 2001, the Commission had licensed 12,932 radio stations (both commercial and noncommercial).[284] According to Commission staff review of BIA Publications, Inc., Master Access Radio Analyzer Database on March 14, 2001, about 10,400 commercial radio stations had revenue of $5 million or less. We note, however, that many radio stations are affiliated with much larger corporations with much higher revenue. Our estimate, therefore, likely overstates the number of small entities that might be affected by reinstatement of the single majority shareholder exemption.

119. The SBA defines small television broadcasting stations as television broadcasting stations with $10.5 million or less in annual receipts.[285] Television broadcasting stations consist of establishments primarily engaged in broadcasting visual programs by television to the public, except cable and other pay television services.[286] Included in this industry are commercial, religious, educational, and other television stations.[287] Also included are establishments primarily are engaged in television broadcasting and which produce taped television program materials.[288] Separate establishments primarily engaged in

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[278] *See Seventh Annual Report,* 16 FCC Rcd at 6110 Table C-1 (2001).

[279] 13 C.F.R. § 121.201, NAICS Code 513112.

[280] Economics and Statistics Administration, Bureau of Census, U.S. Department of Commerce, *1992 Census of Transportation, Communications and Utilities, Establishment and Firm Size, Series UC92-S-1*, Appendix A-9 (1995) (*1992 Census, Series UC92-S-1*, at Appendix A-9).

[281] *Id*.

[282] *Id*.

[283] *Id*.

[284] FCC News Release, No. 25641 (July 13, 2001).

[285] 13 C.F.R. § 121.201, NAICS Code 513120.

[286] *1992 Census, Series UC92-S-1*, at Appendix A-9.

[287] *Id*.; *see* Executive Office of the President, Office of Management and Budget, *Standard Industrial Classification Manual* (1987), at 283, which describes "Television Broadcasting Stations" (SIC code 4833, now NAICS code 513120) as: "Establishments primarily engaged in broadcasting visual programs by television to the public, except cable and other pay television services. Included in this industry are commercial, religious, educational and other television stations. Also included here are establishments primarily engaged in television broadcasting and which produce taped television program materials."

[288] *1992 Census, Series UC92-S-1*, at Appendix A-9.

producing radio program material are classified under another NAICS number.[289] There are currently 1,304 commercial television stations and 374 noncommercial educational television stations on the air (a total of 1,678 stations).[290] According to Commission staff review of the BIA Publications, Inc., Master Access Television Analyzer Database on March 14, 2001, fewer than 800 commercial TV broadcast stations had revenues of less than $10.5 million. We note, however, that under SBA's definition, revenues of affiliates that are not television stations should be aggregated with the television station revenues in determining whether a concern is small. Our estimate, therefore, may overstate the number of small entities because the revenue figure on with it is based does not include or aggregate revenues from non-television affiliated companies.

D. Description of Projected Reporting, Recordkeeping and other Compliance Requirements

120. The *Further Notice* seeks comment on possible regulatory approaches to implement the subscriber and channel occupancy limit provisions of Section 613(f), and on two aspects of its attribution rules that identify the ownership interests implicated by those limits. In considering a subscriber limit approach, the *Further Notice* does solicit comment on whether it would be appropriate to impose reporting requirements, more stringent than those set forth in the Commission's current rule,[291] in order to monitor cable ownership levels. More stringent reporting, recordkeeping, and other compliance requirements, however, likely would affect large MSOs and/or MVPDs, not small entities.

121. The *Further Notice* also seeks comment on whether to reinstate the single majority shareholder exemption for purposes of broadcast and cable/MDS attribution rules. The Commission discussed the effects of projected reporting, recordkeeping, and other compliance requirements based on elimination of the exemption in its reconsideration order released earlier this year.[292] We note that the Commission is suspending enforcement of the elimination of the single majority shareholder exemption for broadcast and cable/MDS attribution rules for all pending cases and until this proceeding is resolved. If the exemption is formally reinstated, reporting requirements will remain unchanged from those requirements that have been in effect since 1984. Thus, the reporting requirements for licensees, including small entities, will not be affected.

E. Steps Taken to Minimize Significant Impact on Small Entities, and Significant Alternatives Considered

122. The IRFA requires an agency to describe any significant alternatives that it has considered in proposing regulatory approaches, which may include, among others, the following four alternatives: (1) the establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (2) the clarification, consolidation, or simplification of compliance or reporting requirements under the rule for small entities; (3) the use of performance, rather than design, standards; and (4) an exemption from coverage of the rule, or any part thereof, for small entities.

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[289] *Id*.

[290] FCC News Release, No. 25641 (July 13, 2001).

[291] *See* 47 C.F.R. § 76.503(g) (requiring any cable operator that serves more than 20 percent of the MVPD market, to file a certification that it will comply with the subscriber limit concurrently with transfer applications).

[292] *Broadcast Attribution MO&O*, 16 FCC Rcd at 1133.

123. The D.C. Circuit, in *Time Warner*, reversed and remanded the Commission's cable subscriber and channel occupancy limits, and vacated two aspects of the Commission's attribution rules. The *Further Notice* seeks comment on several regulatory alternatives to implement the subscriber and channel occupancy limits of Section 613(f), and the two aspects of the attribution rules (the elimination of the single majority shareholder exemption and the application of the insulation criteria to bar limited partners' sale of video programming). For example, alternatives considered in the *Further Notice* include whether to relax, exempt specific cable operators, including small cable operators, from, or eliminate, under certain circumstances, the ownership limits. Other alternatives considered in the *Further Notice* include whether to maintain or eliminate the single majority shareholder exemption and whether or not to bar a limited partner from selling video programming to the general partner cable entity in order to maintain insulated limited partner status for purposes of the attribution rules. In addition, the *Further Notice* considers whether to reinstate or maintain elimination of the single majority shareholder exemption for purposes of the broadcast and cable/MDS attribution rules. We would expect that whichever alternative is chosen, the Commission will seek to minimize any adverse effects on small entities.

F. Federal Rules Which Duplicate, Overlap, or Conflict with the Commission's Proposals

124. There are no federal rules that specifically duplicate, overlap or conflict with the Commission's proposed regulatory approaches to implement Section 613(f) or to re-examine the status of the single majority shareholder exemption for purposes of the broadcast and cable/MDS attribution rules.

VIII. PAPERWORK REDUCTION ACT

125. This FNPRM may contain either a proposed or modified information collection. As part of its continuing effort to reduce paperwork burdens, we invite the general public and the Office of Management and Budget (OMB) to take this opportunity to comment on the information collections contained in this FNPRM, as required by the Paperwork Reduction Act of 1995, Pub. L. No. 104-13. Public and agency comments are due at the same time as other comments on this FNPRM; OMB comments are due 60 days from date of publication of this FNPRM in the Federal Register. Comments should address: (a) whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information shall have practical utility; (b) the accuracy of the Commission's burden estimates; (c) ways to enhance the quality, utility, and clarity of the information collected; and (d) ways to minimize the burden of the collection of information on the respondents, including the use of automated collection techniques or other forms of information technology.

126. Written comments by the public on the proposed and/or modified information collections are due on or before 75 days after date of publication in the Federal Register. Written comments must be submitted by the Office of Management and Budget (OMB) on the proposed and/or modified information collections on or before 60 days after date of publication in the Federal Register. In addition to filing comments with the Secretary, a copy of any comments on the information collections contained herein should be submitted to Judy Boley, Federal Communications Commission, Room 1-C804, 445 12th Street, S.W., Washington, DC 20554, or via the Internet to jboley@fcc.gov and to Edward C. Springer, OMB Desk Officer, 10236 NEOB, 725 17th Street, N.W., Washington, DC 20503 or via the Internet to Edward.Springer@omb.eop.gov.

IX. PROCEDURAL PROVISIONS

127. *Comments and Reply Comments.* Pursuant to applicable procedures set forth in sections 1.415 and 1.419 of the Commission's rules,[293] interested parties may file comments on or before 75 days after date of publication in the Federal Register, and reply comments on or before 105 days after date of publication in the Federal Register. Comments may be filed using the Commission's Electronic Comment Filing System (ECFS) or by filing paper copies.[294] Comments filed through the ECFS can be sent as an electronic file via the Internet to <http://www.fcc.gov/e-file/ecfs.html>. Generally, only one copy of an electronic submission must be filed. If more than one docket or rulemaking number appears in the caption of this proceeding, commenters must transmit one electronic copy of the comments to each docket or rulemaking number referenced in the caption. In completing the transmittal screen, electronic filers should include their full name, Postal Service mailing address, and the applicable docket or rulemaking number. Parties may also submit an electronic comment by Internet e-mail. To receive filing instructions for e-mail comments, commenters should send an e-mail to ecfs@fcc.gov, and should include the following words in the body of the message, "get form <your e-mail address." A sample form and directions will be sent in reply.

128. Parties who choose to file by paper must file an original and four copies of each filing. If participants want each Commissioner to receive a personal copy of their comments, an original plus nine copies must be filed. If more than one docket or rulemaking number appears in the caption of this proceeding commenters must submit two additional copies for each additional docket or rulemaking number. All filings must be sent to the Commission's Secretary, Magalie Roman Salas, Office of the Secretary, Federal Communications Commission, 445 12th Street, SW, Washington DC 20554. One copy of each filing also must be filed with other offices, as follows: (1) Qualex International, Portals II, 445 12th Street, SW, Room CY-B402, Washington, DC, 20554; and (2) Ava Holly Berland, Cable Services Bureau, 445 12th Street, SW, 3-A832, Washington, DC, 20554. In addition, five copies of each filing must be filed with Linda Senecal, Cable Services Bureau, 445 12th Street, SW, 3-A729, Washington, DC 20554.

129. Comments and reply comments will be available for public inspection during regular business hours in the FCC Reference Center, Federal Communications Commission, 445 12th Street, SW, CY-A257, Washington, DC 20554. Persons with disabilities who need assistance in the FCC Reference Center may contact Bill Cline at (202) 418-0270, (202) 418-7365 TTY, or bcline@fcc.gov. Comments and reply comments also will be available electronically at the Commission's Disabilities Issues Task Force web site: www.fcc.gov/dtf, and also from the Commission's Electronic Comment Filing System. Comments and reply comments are available electronically in ASCII text, Word 97, and Adobe Acrobat. Copies of filings in this proceeding may be obtained from Qualex International, Portals II, 445 12th Street, SW, Room, CY-B402, Washington, DC, 20554, telephone (202) 863-2893, facsimile (202) 863-2898, or via email qualexint@aol.com.

130. This document is available in alternative formats (computer diskette, large print, audio cassette, and Braille). Persons who need documents in such formats may contact Brian Millin at (202) 418-7426, TTY (202) 418-7365, or send an email to access@fcc.gov.

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[293] 47 C.F.R. §§ 1.415 and 1.419.

[294] *See Electronic Filing of Documents in Rulemaking Proceedings,* 63 Fed. Reg. 24121 (1998).

131. The media contact for this proceeding is Michelle Russo at (202) 418-0270. The Cable Services Bureau contacts for this proceeding are Daniel Hodes, Kiran Duwadi, Ava Holly Berland or Andrew Wise at (202) 418-7200, TTY at (202) 418-7365 or (888) 835-5322, or at dhodes@fcc.gov, kduwadi@fcc.gov, hberland@fcc.gov, awise@fcc.gov.

132. *Ex Parte Rules.* This proceeding will be treated as a "permit-but-disclose" proceeding, subject to the "permit-but-disclose" requirements under section 1.1206(b) of the Commission's rules.[295] Ex parte presentations are permissible if disclosed in accordance with Commission rules, except during the Sunshine Agenda period when presentations, ex parte or otherwise, are generally prohibited. Persons making oral ex parte presentations are reminded that a memorandum summarizing a presentation must contain a summary of the substance and not merely a listing of the subjects discussed. More than a one or two sentence description of the views and arguments presented is generally required.[296] Additional rules pertaining to oral and written presentations are set forth in section 1.1206(b) of the Commission's rules. Finally, one copy of each disclosure filing also must be filed with other offices, as follows: (1) Qualex International, Portals II, 445 12th Street, SW, Room CY-B402, Washington, DC, 20554; (2) Ava Holly Berland, Cable Services Bureau, 445 12th Street, SW, 3-A832, Washington, DC, 20554; and (3) Linda Senecal, Cable Services Bureau, 445 12th Street, SW, 3-A729, Washington, DC, 20554.

X. ORDERING CLAUSES

133. Accordingly, IT IS ORDERED that, pursuant to the authority contained in sections 2(a), 4(i), 303, 307, 309, 310, and 613 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 152(a), 154(i), 303, 307, 309, 310, 533, the Further Notice of Proposed Rulemaking is ADOPTED.

134. IT IS FURTHER ORDERED that, pursuant to the authority contained in sections 4(i), 303(j) and 613(f) of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154(i), 303(j) and 533(f) and section 1.106 of the Commission's rules and regulations, 47 C.F.R. § 1.106, the petitions for reconsideration jointly filed by the Consumer Federation of America, the Center for Media Education, the Association of Independent Video and Filmmakers, and the Office of Communication, Inc., and United Church of Christ IS DISMISSED AS MOOT.

135. IT IS FURTHER ORDERED that the Commission's Consumer Information Bureau, Reference Information Center, shall send a copy of this Further Notice, including the Initial Regulatory Flexibility Analysis, to the Chief Counsel for Advocacy of the Small Business Administration.

FEDERAL COMMUNICATIONS COMMISSION

Magalie Roman Salas
Secretary

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[295] 47 C.F.R. § 1.1206(b).

[296] *See* 47 C.F.R. § 1.1206(b)(2).

**SEPARATE STATEMENT
OF COMMISSIONER MICHAEL J. COPPS
ON CABLE OWNERSHIP NPRM**

In commencing this proceeding today, the Commission takes steps to fulfill statutory and judicial mandates. Pursuant to the 1992 Cable Act, the Commission established horizontal and vertical ownership rules for cable systems. In a decision this year, however, the D.C. Circuit ordered the Commission to revisit these rules, and to build a strong record upon which to base such changes.

Given the directive of the D.C. Circuit, it is critical that in the proceeding commenced today, we solicit information from all stakeholders to aid us in building a record that will clearly and strongly support our conclusions. Whatever one's position on the outcome of this proceeding, detailed input is important to the Commission's collection of the data necessary to make informed decisions about these rules. The more information we have from stakeholders, the better we will be able to base our decisions not on our impressions of these industries and how they operate, but on the data compiled through proceedings such as this.

I look forward to reviewing the information compiled in response to this NPRM. I intend to review the record thoroughly and without prejudgment. If I am to support any changes to these rules – or any other rule – I expect to know with as much precision as possible how those proposed changes serve the public interest, convenience and necessity.