THE FCC'S CABLE INQUIRY: AN OPPORTUNITY TO REAFFIRM THE CABLE ACT

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I. INTRODUCTION

The Federal Communications Commission ("FCC" or "Commission") has opened a major inquiry into cable television,[1] hoping to resolve conflicting claims about the success of the Cable Communications Policy Act of 1984 (the "Cable Act").[2] The FCC is to be commended for its thoroughness in eliciting factual information about the cable industry. Too often public policy decisions are made based upon anecdotal evidence alone, leading to inappropriate and often arbitrary remedies. In this case, most of the criticisms of the cable industry to the FCC have been made by cable's business competitors, who seek to use the regulatory process to gain competitive and economic advantages for themselves.[3]

The Commission correctly observes that the cable industry has enjoyed tremendous growth over the past decade.[4] Cable

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1 Notice of Inquiry, In the Matter of Competition, Rate Deregulation and the Commission's Policies Relating to the Provision of Cable Television Service, MM Docket No. 89-600, 5 F.C.C. Rcd. 362 (Dec. 29, 1989) [hereinafter Notice of Inquiry].

2 Cable Communications Policy Act of 1984, Pub. L. No. 98-549, 98 Stat. 2779 (1984) (codified at 47 U.S.C. §§ 521-559 (Supp. V 1987)).

3 Cable's competitors include the broadcast, telephone, Multichannel Multipoint Distribution Service ("MMDS"), and backyard satellite dish industries.

4 From 1980 through 1989, basic cable subscribership grew from 17.7 million to 52.6 million television households, more than a three-fold increase over the decade. CABLE TV FACTS 90, CABLETELEVISION ADVERTISING BUREAU, INC. 4 (1990) [hereinafter CABLE TV FACTS 90]. Although the three commercial broadcast networks (49%) and independent television stations (16%) account for nearly two-thirds of viewership in cable households, cable programming services now attract a 39% viewership share among cable subscribers, according to Cabletelevision Advertising Bureau statistics which take into account multiple set usage. *Id.* at 12-13. The viewership of both independent television stations and cable channels steadily increased during the decade as the dominance of the three networks lessened. Due in large part to expanded reach and

has transformed American television from a system overwhelmingly dominated by three broadcast networks to one in which consumers choose from among a multitude of programming choices. As importantly, the decade saw the rapid growth of the home video industry.[5] The telephone industry saw its revenues climb to $91.7 billion in 1989 as the Bell Operating Companies were able to engage in new lines of business as a result of the break-up of AT&T.[6] Local exchange carriers now provide gateways to such services as Prodigy, CompuServe, and Dialog, which also service the home entertainment/information market.[7] As a result of these dynamic changes, competition increased for consumers' entertainment and information dollars. Using the regulatory process to gain competitive and economic advantage, cable's competitors have attempted to hamstring the cable industry's ability to modernize plant, develop new programming, and compete in the programming marketplace, thereby capturing consumers' discretionary income for themselves.

While the cable industry's business competitors such as Independent Television, Inc. ("INTV"), the Wireless Cable Association, and United States Telephone Association ("USTA") have all made numerous allegations concerning the cable industry's conduct,[8] most of these allegations do not withstand factual scrutiny. As the Commission announced, its proper goal is to develop a factual record to enable it to determine "whether, in fact, the cable industry has engaged to a significant degree in the practices with which others have charged it . . . ."[9] In an industry as diverse as the cable industry, with more than 670 cable system

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enhancement of their signal quality by cable carriage, the number of independent television stations nearly tripled during the decade. *See 1990 INTV Census: The Complete Directory Of The Independent Television Marketplace*, at 18 (Jan. 1990) (115 independent stations in 1980 as compared to 339 in 1989).

[5] Today, far more television households own VCRs than subscribe to cable. As of February 1990, 68% of television households own VCRs. ELECTRONIC INDUS. ASS'N CONSUMER ELECTRONICS GROUP, CONSUMER ELECTRONICS ANNUAL REVIEW 62 (1990). The Commission uses the figure of 64% VCR penetration. Notice of Inquiry, *supra* note 1, at 373-74 & n.84. Using the Notice of Inquiry's figure of 56.4% for cable penetration of television households, VCR penetration is much greater than cable penetration. Notice of Inquiry, *supra* note 1, at 362.

More importantly, VCR households spend an average of $14 per month on video cassette rentals and purchases. The home video industry is now a $11.5 billion industry, more than half the size of the cable industry. Nichols, *Movie Rentals Fade, Forcing The Videocassette Industry To Shift Its Focus*, N.Y. Times, May 6, 1990, at 34, col. 4.

[6] UNITED STATES TELEPHONE ASS'N, PHONE FACTS '89, 1989 ANNUAL REPORT 3 (1990).

[7] *See infra* note 68.

[8] *See, e.g.*, INTV Petition for Rulemaking and Supplemental Statement in Support of Notice of Inquiry, MM Doc. No. 89-600 (Oct. 23, 1989).

[9] Notice of Inquiry, *supra* note 1, at 5 F.C.C. Rcd. 363.

operators serving 24,678 communities,[10] some companies' behavior will inevitably fall short. The vast majority of companies, however, should not be painted with the same brush.

This Article suggests that those who advocate government intervention should have the burden of proving that there is a pattern of practices that compels such intervention. Following the subject headings set forth in the Notice of Inquiry, Part II of this Article examines local competition and market power. Part III discusses the remedies available to encourage alternatives to cable. Part IV discusses access and signal carriage. Part V evaluates various regulatory options. Finally, Part VI examines national concentration, vertical integration, and market power.

II. Local Competition and Market Power: Cable Rates and Service

A. *The Effects of Rate Deregulation on Consumers*

Since 1986, a chorus of cable competitors and city officials have decried post-Cable Act rate increases, relying for the most part, on selectively chosen anecdotal evidence. With the release of the August 1989 Government Accounting Office ("GAO") survey,[11] a more accurate picture of the effects of basic rate deregulation on consumers began to emerge. The information that GAO compiled focused not only on basic cable rates, but also on the total bill paid by cable consumers. The GAO survey showed that the average cable consumer's bill rose approximately 7% annually during the first two years following deregulation.[12]

From December 1986 to October 1988, the monthly average revenue to cable operators per subscriber increased 14%.[13] These results match the Labor Department's Consumer Price Index ("CPI") for cable which validate that cable rates went up by

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10 *Television & Cable Factbook*, Cable & Services Vol. No. 57, at c-384 (1989 ed.). The figure of 670 cable system operators was obtained in a telephone interview with D. Kohlmeyer, *Television and Cable Factbook* (May 7, 1990).

11 *United States General Accounting Office, National Survey of Cable Television Rates and Services: Report to the Chairman, Subcomm. on Telecommunications and Finance, House Comm. on Energy and Commerce*, GAO/RCED-89-193 (Aug. 1989) [hereinafter *GAO Survey*].

12 *See id.* at 23-38.

13 *Id.* The GAO Survey, *supra* note 11, states that

> [t]he 'bottom line' after sorting out various increases and decreases in basic rates, options, and premium channels is their effect on the cable systems' total revenues. Monthly average revenue to cable operators per subscriber increased from $21.58 to $24.68 between December 1986 and October 1988, an increase of 14 percent.

Id. at 6.

21% from January 1, 1987 to December 31, 1988.[14] Even more significantly, the Department's Bureau of Labor Statistics ("BLS") survey of consumer prices showed that the cable portion of the CPI rose only 3.8% during 1989 while the overall CPI for the same period rose 4.6%.[15] This is clear evidence that cable rate increases are consistent with other consumer prices.[16] Further, despite the fact that many cable systems implement annual rate increases in January, cable rates increased only 1.2% in January 1990,[17] while overall CPI rose 1% for the same period.[18]

As importantly, the GAO survey showed that the post-Cable Act rate increases were accompanied by the addition of 5 to 6 new basic programming channels to basic service tiers.[19] Thus, consumers received nearly 20% more basic programming. Consequently, the cost per channel of basic programming increased from 44 cents to just 46 cents between December 1986 and October 1988.[20]

B. *Cable Rate Increases Over Longer Time Periods*

GAO's finding that basic rates increased by a greater percentage in 1987 and 1988 than subscribers' total bills reflects the fact that prices for pay television services such as HBO, Showtime, and other options decreased or remained the same during that period. Because pay television rates had been deregulated since 1972, this result is not surprising. Historically, cable rates had been distorted both by city franchising processes and because a portion of each subscriber's bill, basic cable, was subject to rate regulation and a portion, pay television and other optional services, was not. As a result, an artificial situation was created whereby pay television and other options were used to subsidize basic rates.[21] Basic rate deregulation finally allowed cable operators to set prices that were reflective of the true value of services provided.

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14 *Compare* BUREAU OF LABOR STATISTICS, UNITED STATES DEP'T OF LABOR, CONSUMER PRICE INDEX DETAILED REPORT DECEMBER 1986 Table 5 (CPI-U) (116.8 unadjusted index for Dec. 1986) *with* Table 4 (CPI-U) (141.4 unadjusted index for Dec. 1988).

15 BUREAU OF LABOR STATISTICS, UNITED STATES DEP'T OF LABOR, CONSUMER PRICE INDEX, Table 4 (CPI-U.S. city average).

16 *Id.* at Tables 3 (Historical CPI-U) & 4 (CPI-U.S. city average).

17 *Id.* (current cable figures obtained from BLS computer).

18 *Id.* at Table 4 (current figures obtained from BLS computer).

19 *GAO Survey*, *supra* note 11, at 4.

20 *Id.* at 26.

21 Using Continental, for example, in 1984, pay television subscriptions contributed 44.5% of revenues, while basic subscriptions contributed 51.7%. In contrast, pay television accounted for only 31.8% of total revenues in 1989 whereas basic cable accounted for 63.8%.

The fact that cable's product has dramatically changed and expanded over time is not easy to capture in any rate survey. The best way to illustrate this is to examine basic rates over the last 25 years. For example, when Continental built its first system in Tiffin, Ohio in 1964, it offered subscribers 10 channels of basic programming for $4.95 per month, or roughly 50 cents per channel. That service consisted of 3 CBS stations, 2 NBC stations, 2 ABC stations, 2 independents, and a local origination/community bulletin board channel. In 1964, there was no special cable programming. In contrast, subscribers in Tiffin in 1990 receive 31 channels of basic programming, more than three times the number received in 1964. If this $4.95/1964 rate had been adjusted annually for inflation, it would be $19.60 today. In fact, Continental's basic rate is $15.50. Therefore, in real dollars, the cost of basic cable has decreased in Tiffin. On the other hand, cable subscribers are receiving three times as much programming for every dollar they spend on cable. The Tiffin system is not unusual. Indeed, it typifies what has happened in the industry with respect to cable rates.[22]

C. *Comparison of Cable with Costs of Telephone and Broadcasting*

It is also useful to compare the price of cable with the price of other consumer goods and services. Most cable subscribers choose a mix of services.[23] Cable television provides the average basic subscriber with 35 channels of entertainment and information programming for less than 50 cents a day.[24] Basic cable rates also compare favorably with local residential telephone

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[22] In looking back at 1964, it should be noted that the *Tiffin Advertiser Tribune*, the city's daily newspaper, cost 7 cents at the newsstand. Today it costs 35 cents, a 400% increase. And in 1964, a movie ticket in Tiffin cost 75 cents for adults and 30 cents for children. The prices today in Tiffin are $4.50 for adults and $2.50 for children, 500% and 733% higher than they were in 1964. Continental's basic cable rate, on the other hand, has increased 215% over those 25 years, considerably less than the rate of inflation.

[23] An average subscriber to Continental, for example, takes basic plus at least one pay television channel such as HBO or Showtime.

[24] Basic services include twenty-four hours of news on CNN, round-the-clock sports on ESPN, the world of science on Discovery, Arts & Entertainment, children's shows on Nickelodeon, Cable Satellite Public Affairs Network ("C-SPAN I" and "C-SPAN II"), The Learning Channel, Turner Network Television, USA Network, Lifetime, MTV, Black Entertainment Television, Hispanic programming, and much more.

The average basic rate for one month of cable is $14.77. *GAO Survey*, *supra* note 11, at 1 & n.1. Consequently, consumers pay less for an entire month of cable television, than a family of four pays to go to one two-hour movie, sit in the grandstand at a baseball game, or purchase the least expensive theater ticket in town. For up-to-minute news and consumer information, the 50 cents a day consumers pay for basic service, the daily cost of *USA Today* or *The Wall Street Journal*, allows them to receive informational services such as CNN Headline News, FNN, CNBC, and the Weather Channel.

rates. As of December 1988, local phone rates averaged $16.50 per month and had increased 57% since divestiture.[25] Moreover, consumers use their television sets 7 hours per day as opposed to the 25 minutes per day they use their telephones.

Comparing the cost of cable with the cost of "free television" indicates that "free television" is not free and in fact costs the consumer the same as cable television. The broadcast industry does not like to acknowledge that broadcast television imposes any costs on consumers. However, the reality is that broadcast television imposes substantial costs. Every time consumers purchase gas, beer, aspirin, or virtually any other product, part of the purchase price is for advertising.[26] Using A.C. Neilsen Company's estimate of 92.04 million television households at year end 1989,[27] broadcasting revenue per television household amounted to $293.35/year or $24.45/month in 1989. Interestingly, the $24.45 "free television" involuntary monthly fee was more than the $268.06 per year or $22.33 per month fee that the average cable television household paid for basic and pay service in 1989.[28]

But, because "free television" fees are passed on to consumers indirectly through the products they buy, there is no outpouring of complaint about, or indeed any public examination of, broadcaster advertising fees. No one calls for investigation of broadcast station sales, vertical integration, or exclusivity in the broadcasting industry.

D. *Cable's Increased Expenditures Since the Cable Act*

To properly assess post-Cable Act rate increases, the Commission should also examine the expense side of the cable industry's ledger. Upon such examination, the FCC would find that increases in cable rates have been accompanied by substantial, new investment in plant and equipment, programming, training,

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25 KIMMELMAN & COOPER, DIVESTITURE PLUS FIVE, RESIDENTIAL TELEPHONE SERVICE FIVE YEARS AFTER BREAKUP OF AT&T (published by Consumer Fed'n of America, Washington, D.C.) (Dec. 1988). Furthermore, unlike local phone companies, most cable companies do not impose extra charges on consumers for service calls.

26 According to McCann Ericson, the broadcasting industry realized $27.215 billion in advertising revenue in 1989. *Television & Cable Factbook*, Cable & Services Vol. No. 58 (forthcoming 1990 ed.).

27 NIELSEN STATION INDEX, 1989 U.S. TELEVISION HOUSEHOLD ESTIMATES 1 (estimates as of Jan. 1990).

28 According to the Cabletelevision Advertising Bureau, Inc., total 1989 cable industry revenues for basic and pay TV services were $14.1 billion. At year end 1989, there were approximately 52.6 million cable TV households. CABLE TV FACTS 90, *supra* note 4, at 4-5.

and customer service. The FCC will also find that franchise fees and taxes on cable have increased substantially since passage of the Cable Act.[29]

1. Increased Plant Expenditures

Since deregulation, the substantial capital investment cable operators have made in new construction and system rebuilds has been ignored in much of the dialogue about cable rates.[30] Many of those who criticize the cable industry fail to recognize the correlation between these expenditures and consumer prices. Even the raw numbers fail to tell the whole story because they do not fully capture improvements in picture quality, system reliability, and program choice for consumers.[31]

Passage of the Cable Act created an atmosphere in which companies proceeded aggressively to rebuild cable systems, extend plant to low density areas, and construct new cable systems in urban areas.[32] By 1984, most suburban and rural areas of the country had enjoyed cable services for many years. However, urban areas such as Cleveland, Detroit, Washington, D.C., and large sections of Los Angeles and New York City were still unserved. While some of the delays in wiring our nation's cities may be ascribed to cities' protracted franchising processes, delays were also the result of companies' inability to obtain financing for such risky urban projects. Enactment of the Cable Act eased the availability of financing.[33]

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29 In 1989, cable companies paid states and municipalities franchise fees equivalent to more than half of the industry's billion dollar basic programming expense.

30 In 1986, prior to deregulation, the cable industry spent $246 million to expand and upgrade existing plant, $6 million less than it had during the previous year. According to Kagan Associates, under deregulation, investment in plant increased 110% to $515 million from 1986 to 1989.

31 The cable industry has also invested millions of dollars in fiber optic technology. Cable has deployed fiber under a variety of circumstances to transport signals over long distances, upgrade the channel capacity of existing systems, and improve picture quality by reducing noise and distortion. The economic climate created by the Cable Act has played a major role in these investments. *See* Haugsted, *California System To Start $27M Rebuild*, Multichannel News, Jan. 22, 1990, at 4, col. 1 (discussing Continental's Stockton, California fiber rebuild).

32 During the five year period since enactment of the Cable Act, Continental, for example, spent more than half a billion dollars on capital additions, exclusive of system acquisition costs.

33 In mid-1987, for example, Continental began construction of the cable system serving South Central Los Angeles. By 1990, Continental had spent more than $47 million on the 650 mile project (500 miles of plant are now built). South Central Los Angeles is comprised of a largely economically depressed, multi-ethnic minority community. Despite the fact that the rest of Los Angeles had been franchised and has had cable service available for over a decade, no one was willing to make the required financial investment to wire all of South Central. Since construction began in late 1987, 30,000

2. Programming Cost Increases

Although consumer bills increased a few percentage points more than the rate of inflation in 1987 and 1988, subscribers received almost 20% more programming.[34] In 1988, the cable industry spent $745 million on basic programming, 69% more than it had spent in 1986, the last year of rate regulation.[35]

Cable operators have incurred significant increases in basic programming expenses in the area of sports programming. For example, in 1988, Madison Square Garden ("MSG"), owned by Gulf & Western (now Paramount Communications, Inc.), paid a reported $500 million to acquire the television rights for New York Yankees baseball.[36] Because of the substantial price Gulf & Western had bid for the Yankees, it immediately sought to pass the cost to cable operators. Unfortunately, a negative campaign by New York sportswriters, coupled with threats of more negative press from Gulf & Western, eventually forced cable operators to capitulate to Gulf & Western's demands. In the end, most operators raised their basic rates and continued carrying MSG as a basic service. All customers had to bear a significant expense for programming that only a minority wanted, an unsatisfactory result. The answer is for cable operators to be able to offer the most expensive basic services—sports or other services that experience dramatic price increases—on a premium basis.

Local programming costs have also increased. The cable industry provides millions of dollars annually for local origination and public access programming. The cable industry agreed to continue such support as part of the compromises struck in the Cable Act. In 1990, cable industry support of community programming will exceed a quarter of a billion dollars.[37] Further,

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households have subscribed. This represents slightly less than a 30% basic penetration rate, underscoring once again the difficult challenge of cabling central city areas.

[34] *See supra* notes 17-19 and accompanying text.

[35] The cable industry spent $513 million on basic programming in 1986. Materials distributed at Kagan Cable TV Programming Seminar, Apr. 17, 1990 (chart entitled Cable Program Spending Trends). According to Kagan Associates, basic programming expenditures increased another $200 million to $945 million in 1989 and are projected to be $1090 million in 1990. *Id.*

[36] *See* Thomas, *Yanks Sell TV Rights to MSG for $500 Million*, N.Y. Times, Dec. 10, 1988, at 47, col. 2. At that time, MSG was carried as a basic service on many New York City-area cable systems but as an optional premium service on some. Even before its New York Yankees acquisition, MSG was one of the most expensive basic services carried by New York area cable operators. With the Yankees purchase, MSG became the most expensive. For cable operators, a decision had to be made as to whether MSG should continue to be carried as a basic service, requiring all subscribers to pay for it, or whether it should be offered to subscribers as a premium option.

[37] Continental alone, with over a hundred local studios across the country, invests millions of dollars annually in local programming activities, producing tens of thousands

community service contributions have increased. Providing a "voice" for the often overlooked members of society is another of cable's unique contributions.[38]

3. Employee Training and Customer Service

Another by-product of rate deregulation is that cable companies have been able to devote more resources to employee training and customer service.[39] To improve the technical skills of existing workers and new hires, cable operators have made a substantial investment in establishing training facilities and developing training courses.[40] While improving system reliability and improving customer satisfaction,[41] cable's training programs also help to increase the number of women and minorities employed in non-traditional areas of the cable industry such as installation and field maintenance.

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of hours of local programs each year. For example, Continental's Springfield, Massachusetts system cablecasts over 20 different program series ranging from shows for children, sports fans, and the elderly to programs on financial planning, health, fitness, and local issues. In 1989, the system produced over 1000 hours of programming. The system's local educational channel features programming from a variety of colleges and government channels that carry city council meetings as well as gavel-to-gavel coverage of the state legislature.

[38] The Cable Television Alliance for Education is a consortium of cable operators and programmers who have joined together to match the resources of cable television with the needs of America's schools. In May of 1989, Continental Cablevision announced its "Cable in the Classroom" initiative: providing schools with an extraordinary range of commercial-free educational programming and teacher aids. "Cable in the Classroom" includes CNN "Newsroom," a daily 15-minute newscast produced for students by Cable News Network; two daily hour-long blocks of contemporary issues, arts, humanities, and social studies programs from The Discovery Channel and the Arts and Entertainment Network; and the Cable Satellite Public Affairs Network (C-SPAN) vignettes on how government works as well as coverage of Congress. Continental has committed to provide "Cable in the Classroom" programming, which includes basic cable service, at no cost to every junior and senior high school in the 600 communities Continental serves, and includes basic cable service also offered to those schools at no cost.

[39] For example, Continental now spends almost $2,000 annually per employee on training and has training facilities in most operating regions where such facilities did not exist prior 1984.

[40] Cable has also increased investment in advanced telecommunications systems, expanding training and hiring additional customer service representatives, making significant gains in the customer service area. In addition to expanded telephone service hours, walk-in customer service has been improved by increasing the number of customer service centers and by expanding operating hours. Prior to deregulation, most installation and repair services were provided between 9 a.m. and 5 p.m., Monday through Friday. Today, virtually all cable systems have extended installation and repair hours to 7 p.m. or later and offer in-home service 6 or 7 days per week. In some systems, same day service calls are the norm and service appointment blocks have been reduced to 2 hours.

[41] In a continuing effort to improve cable's customer service performance, regular subscriber surveys are used to detect customer service deficiencies and help managers improve customer service performance.

4. Franchise Fees and Taxes

Franchise fees and state and local taxes are yet another area where operating expenses have increased. What is often overlooked in the focus on cable rate data since deregulation under the Cable Act is that as part of the compromise that led to the enactment of the Cable Act, the cable industry agreed to a 66% increase in the amount cities could charge in franchise fees. As a result, franchise fees in many cities have been able to increase from 3% to 5% of gross revenues.[42] In 1989, cities and states received more than half a billion dollars in franchise fee payments, which cable operators pay in addition to other taxes. The fact that these franchise fee increases are reflected in increased cable rates is often ignored by the same city officials who have complained the loudest about cable rates.

However, cable franchise fees are not the only state and local levies that have increased. In Connecticut, where cable systems are franchised and regulated by the Department of Public Utilities Control, cable operators were recently saddled with an 8% sales tax on basic and pay cable rates,[43] in addition to franchise fees equal to 5% of gross revenues.[44] Over the course of a year, the equivalent of one and one half months of each subscriber's cable bill will go to the state. In California, communities are imposing "possessory interest taxes" on top of franchise fees and real and personal property taxes, maintaining that the tax is for the cable system's "possessory interest" in the public rights-of-way, *i.e.*, that share of the public property which the cable system occupies but does not own.[45] Cable television offers a great many public benefits, but it should not be viewed as the answer to every state's budgetary needs. If states and municipalities continue to impose higher taxes on cable systems, then they should accept responsibility when these taxes cause higher cable bills.

E. *Potential Competitors to Cable and the Relevant Market*

The question of "relevant market" in the cable industry is central to the FCC Notice of Inquiry.[46] Simple antitrust analysis puts to rest the notion that cable is an essential or "bottleneck"

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[42] *GAO Survey*, *supra* note 11, at 3.
[43] CONN. GEN. STAT. § 12-407(2)(i)(l) (Supp. 1989).
[44] CONN. GEN. STAT. § 12-258 (1983 & Supp. 1989).
[45] For instance, from 1986 to 1987, Continental's Yuba, California system experienced a 1600% increase in the so-called possessory interest tax, from $18,000 to $307,000. This increase added 90 cents a month to each subscriber's bill.
[46] Notice of Inquiry, *supra* note 1, at 365.

service.[47] Any rational method of defining the relevant product market also shows conclusively cable's inability to exercise market power. Cable is just one provider of entertainment and information services in a robust market. It must respond to the economic pressures of the highly competitive communications industry.

The first step in antitrust analysis under the "bottleneck" or essential facilities doctrine is determining whether use of a particular facility is compulsory in order to provide the service.[48] There must also be an inability on the part of a competitor to duplicate the facility.[49] Bottleneck monopoly cases normally involve essential utilities such as water or electricity or access to a single transportation terminus.[50]

Far from being an essential, bottleneck facility, cable faces competition in every segment and submarket in which it participates. Cable operators do not control the many facilities by which video services are provided to the consumer. Cable operators compete with other cable operators to gain franchises. Finally, they "compete" with a variety of potential entrants to the video industry that are developing alternatives to cable distribution, such as Multichannel Multipoint Distribution Service ("MMDS") and Direct Broadcast Satellite ("DBS").

Equally unavailing are claims that cable companies exert market power. The Justice Department defines market power as "the ability of one or more firms profitably to maintain prices above competitive levels for a significant period of time."[51] To make a determination of market power, the Department of Justice first defines the relevant market in which the product competes and then examines the demand responses of consumers and the supply responses of other firms.

An expansive view of the products to be included in the relevant market with cable has been supported by the courts. In a 1983 case brought by a Satellite Master Antenna Television ("SMATV") operator challenging exclusive contracts that a cable operator had entered into with an apartment house owner, for

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[47] *See infra* notes 48-49 and accompanying text.

[48] *See, e.g.*, United States v. Terminal R.R. Assoc., 224 U.S. 383, 398 (1912).

[49] MCI Communications Corp. v. A.T.& T. Co., 708 F.2d 1081, 1132 (7th Cir.), *cert. denied*, 464 U.S. 891 (1983).

[50] *See, e.g.*, *Terminal R.R.*, 224 U.S. 383 (1912) (group of railroads acquired control of all routes crossing Mississippi River and therefore controlled only access to transcontinental travel and commerce); Otter Tail Power Co. v. United States, 410 U.S. 369 (1973) (electric utility refused to sell power at wholesale prices to municipal systems).

[51] DEPARTMENT OF JUSTICE, 1984 MERGER GUIDELINES, ANTITRUST DIVISION MANUAL, § 2.0, at 7-31 (1990).

example, the Fourth Circuit defined the relevant market more broadly than merely video cassettes and broadcast television to the home, including movie theatres and other types of leisure and entertainment related businesses.[52] Another circuit more recently came to a similar conclusion, finding the relevant market was "passive visual entertainment which included cable television, satellite television, video cassette recordings, and free over-the-air television."[53] The court stated that "these products all constitute a single relevant product market and . . . are reasonably interchangable by consumers."[54]

Recent trends in consumer preference for a night at the movies have borne out this expansive view. The return of the "big screen" to movie theatres across the country in response to consumer demand demonstrates the willingness of consumers to leave the home for video entertainment.[55] Even if cable television is viewed more narrowly, as the provision of video programs to the home, the market is still broad. Numerous past FCC reports have indicated that cable competes with broadcast television as well as VCRs, home dishes, and a variety of other media.[56] Although cable provides a broad variety of programming, the degree to which these services are provided by other sources and whether the consumer would turn to these sources in response to increased cable rates will define the market.

1. Broadcasting

Off-the-air television service, one of cable's competitors, is received in all but a small percentage of American homes. This source of video entertainment provides, or has the present capability to provide, all the one-way, non-interactive entertainment and information services that the principal services consumers desire from cable. In economic terms, this is a perfect substitute. In fact, American consumers have proven that broadcast television is regarded as a substitute for cable and have disproven the

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52 Satellite Television and Associated Resources, Inc. v. Continental Cablevision of Virginia, Inc., 714 F.2d 351 (4th Cir. 1983), *cert. denied*, 465 U.S. 1027 (1984).

53 Cable Holdings of Georgia, Inc. v. Home Video, Inc., 825 F.2d 1559, 1563 (11th Cir. 1987).

54 *Id.*

55 According to the Motion Picture Association of America, increases in box office revenues of up to 12.9% in the last year highlights the success of Hollywood in attracting its share of the consumer's entertainment budget. *See* Franklin, *1989 U.S. Economic Review*, at 1 (Motion Picture Ass'n of America, Inc. 1989).

56 *See* Levy & Setzer, *Measurement of Concentration in Home Video Markets*, FCC OFFICE OF PLANS AND POLICY (Dec. 23, 1982); Levy & Pitsch, *Statistical Evidence of Substitutability Among Video Delivery Systems*, FCC OFFICE OF PLANS AND POLICY (Apr. 1984).

theory that cable is an essential facility.[57] Even under these assumptions, more than one-third of those passed by cable nationally do not subscribe,[58] and far fewer subscribe in urban markets with more broadcast signals. This is due primarily to the continued competition from over-the-air television broadcasts. Because most consumers view broadcasters as providers of "free television," off-the-air television has proven to be a formidable competitor.

Broadcasters themselves concede the diversity of the video entertainment market.[59] Their own data reveals that as consumer demand for more diverse television programming increased beyond that which the three commercial networks supplied, new suppliers, like the independents and cable, entered the market to meet that demand.[60] Other consumers went to other sources for their home video programming needs.

2. Video Cassette Recorders

Although many consumers prefer cable to broadcast television,[61] cable finds a fierce competitor in the video cassette recorder ("VCR") industry. VCRs have penetrated far more American households than cable.[62] Today, 68% of American homes have the capability of choosing from thousands of feature films, children's programming, and educational and cultural documentaries.[63] Video cassettes are available in rental stores and corner convenience markets across the country. Yet, despite the fact that more consumers view the VCR as an essential com-

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57 According to the statistics used by the FCC in the Notice of Inquiry, 81.7% of television households in the United States are passed by cable, but only 56.4% of television households subscribe, for a 68.9% penetration rate nationally. Notice of Inquiry, *supra* note 1, at 369.

58 *Cable Stats*, CABLEVISION, Sept. 11, 1989, at 80 (citing Paul Kagan Associates, Inc. survey).

59 James Hedlund, president of INTV, the independent television industry's trade association, recently made this point loud and clear. At the 1990 INTV Convention entitled *Independent Television: Where the Network Audience Has Gone*, Mr. Hedlund claimed that the independents, not cable, were responsible for the network audience erosion that has taken place in the past few years. "In May 1989, Independent television . . . garnered a 25% share of all television viewing — not one of the Big 3 Networks could exceed a 19 share, and 196 basic cable services combined could produce only 15 share points." INTV Annual Convention, Washington, D.C. at 2 (Jan. 3, 1990) (remarks of James Hedlund).

60 *See supra* note 56.

61 The Roper Organization for the Television Information Office, *America's Watching*, Oxford Lithograph (1989).

62 *See supra* note 5.

63 This 68% figure is based on 91.4 million total television homes. ELECTRONIC INDUS. ASS'N CONSUMER ELECTRONICS GROUP, CONSUMER ELECTRONICS ANNUAL REVIEW 62 (1990).

modity than they do cable, there is no current movement to begin federal or local regulation of the VCR market.

The viability of the VCR as a serious competitor to cable in the video programming market is no surprise to the FCC. The Commission relied on the omnipresence of VCRs when it revived the syndicated exclusivity rules.[64] In that instance, the FCC found that "[t]he rapid increase in VCR penetration, especially in cable households," offered sufficient competition to cable-imported distant signals in providing diversity of viewing times for syndicated programming.[65] Contrasting the state of the market in 1980, when the syndicated exclusivity rules were lifted, and 1988, when they were reimposed, the FCC noted, "there were far fewer alternatives to broadcast signals than there are today."[66] It would be disingenuous of the FCC to now find that this same flourishing diversity is insufficient to maintain competitiveness among video outlets.

Once again, traditional market forces have exerted pressure on supply, demand, and ultimately price. VCR manufacturers, in less than ten years, met a vast majority of the demand for video service. With the VCR's capacity to bring to the consumer nearly all of the types of programming available on cable, the cable operator must price its commodity competitively or be driven out of the market by the combination of broadcast television and VCRs.

3. Home Satellite Dishes

The cable industry faces additional competition from home satellite dishes. The American landscape has taken on a space-age look with nearly 2.4 million home satellite dishes already in use and new sales for 1990 estimated at over 275,000.[67] Any dissatisfied cable consumer has the potential to acquire an earth terminal and gain access to all of the sources available to cable subscribers, and in many cases far more. Home satellites provide a product virtually identical to that provided by cable.

In a free market environment, over-regulation produces inefficiencies. Due to the presence of actual and potential providers of substitutable video services, cable rates are kept at a reasonable level. Consumers purchase cable, VCRs, or home sat-

64 Report and Order, Amendment to Rules Relating to Program Exclusivity, 3 F.C.C. Rcd. 5299 (May 18, 1988).

65 *Id.* at 5307.

66 *Id.*

67 *Execs Predict Strong 1990 Sales; Say TVRO Faces Challenges*, Satellite Business News, Jan. 24, 1990, at 9.

ellite dishes for the quality and diversity of the programming. Broadcasters ought not to receive a consolation prize of increased cable regulation if, in years to come, their product is not preferred to that provided by one of these other technologies.

4. Electronic Information Services

Finally, cable faces competition from a variety of alternative electronic information services. Virtually any information currently provided by cable programming is also available to consumers from a broad range of computer database electronic publishing services. Cable and non-cable households alike can choose from literally thousands of public databases to obtain news, weather, and sports information, as well as financial data and stock quotes.[68] Although these services are interactive and offer search and retrieval capabilities, they provide consumers and business users with data and information that is comparable, or in some cases identical, to the information available from Cable News Network, Financial News Network, C-SPAN, and other cable programming services. In some cases, cable programming is the source or originator of the information that is provided alternatively by the database services.

III. REMEDIES TO ENCOURAGE COMPETITIVE ALTERNATIVES TO CABLE

A. *Changes in the Franchise Process*

In its Notice of Inquiry, the FCC discussed the potential for multiple cable systems to be franchised to spur cable competition.[69] The FCC seized on the municipal franchising process as the possible culprit that prevents what it perceives as adequate competition to cable.[70]

In one of the few judicial proceedings in which an unsuccess-

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68 Moreover, highly specialized information about agriculture, medicine, science, and government is also provided. One database, Prodigy, provides consumers with news from Cable News Network, Associated Press and United Press International. In addition, Prodigy offers stock quotations, updated every 15 minutes, and includes sports and entertainment information. The cost is less than $10 per month and the service may be accessed by regular telephone lines. Another database, from Dialog Information Services, provides consumers and business users with news from Associated Press, United Press International, Businesswire, and McGraw-Hill. In addition to providing stock quotes, Dialog provides financial news from the Financial Times, Moody's, Standard & Poor's, and Reuters. Dialog provides information about government and politics from Commerce Business Daily, The Congressional Record, The Federal Register, and Washington Presstext.™

69 Notice of Inquiry, *supra* note 1, at 366.

70 *Id.*

ful franchise applicant has tried its constitutional claim of entitlement to a second cable franchise to a jury,[71] the court ruled that the unsuccessful applicant had no standing. The court's conclusion was based on the jury's findings that the applicant did not have the intent, the financial ability, or the technical capability to build a second cable system in competition with an existing operator that was awarded the city's franchise during a process in which the plaintiff participated.[72] During the trial, the jury heard testimony on the city's interests in initially limiting to one the number of franchises awarded, including uncontradicted expert analysis of the lack of consumer demand sufficient to support a second cable system. The jury specifically found that the "economic demand for cable television in St. Paul [is] sufficient to support the existence of only one cable television company."[73]

1. Existence of Competing Cable Systems

Many times cable systems are erroneously described as "competing" when in fact the competition, if it exists at all, is limited to only a portion of the operator's service territory. Competition within overlapping service territories does not fully or accurately reflect the financial feasibility of an "overbuild," which is defined as direct head-to-head competition throughout a service area.[74]

The published figures do not reflect which applicants are seeking a complete overbuild of a given franchise area and which seek to serve only partially overlapping service territories.[75] Accordingly, the extent of overbuilds frequently is or can be exaggerated. For these reasons, authoritative data does not exist as to how many subscribers are presently served by competing systems, and the data which does exist may include only limited competition within a service territory as well as instances where competition no longer exists.[76]

[71] Nor-West Cable Communications v. City of Saint Paul, CV 3-83-1228, Special Verdict (D. Minn. June 10, 1988) (court entered judgment for the City of St. Paul, Minnesota after an 8-week trial).

[72] *Id.*

[73] *Id.*

[74] *See* Kagan Seminars, Inc., *Pending Overbuild Franchising Activity* (1989 update).

[75] *Nor-West Cable*, CV 3-83-1288, Tr. 3753 (testimony of Jerry Lindauer, Senior Vice President of Prime Cable).

[76] *Id.* at Tr. 313-18 (testimony of Harry Cushing, President and Chief Executive Officer of Telesat).

2. Factors Affecting Scarcity of Successful Overbuilders

The numerous factors that account for the relative dearth of competing cable systems have been articulated in several pertinent studies.[77] Those studies have made several findings. First, the subscriber cost of providing cable service declines as subscriber penetration increases.[78] Thus, two cable operators serving the same franchise area will each have higher costs per subscriber than those experienced by a single operator serving the franchise area.[79] Consequently, a single operator can provide a given level of service within a particular geographic area at a lower total cost than can two firms.

Second, as a distribution system, cable television possesses generic qualities of "natural monopoly," commonly defined as an industry in which multi-firm production is more costly than production by a monopoly.[80] These attributes include large fixed investments, fixed and essentially immovable connections between supplier and customers, non-storable type of service, and the obligation of instantaneous supply. Third, overbuilds are generally economically viable only in high density, high demand markets.[81] Experience in most markets reveals that neither the density nor the demand is sufficient to make competition among cable companies profitable for the competitors.

Fourth, economies of scale make packaging and selling of services more economical per subscriber for a single large operator than for competing multiple operators.[82] Therefore, cost advantages appear to lie in the integration of transmission and marketing activities. Finally, in the long run, consumers and municipalities may be worse off in overbuild situations due to poorer quality services and higher rates required for the competitors to operate at a profitable level, and because community serv-

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77 *See generally* Browne, Bortz & Coddington, Inc., *Economic and Financial Analysis of Multiple Cable Television Operators in St. Paul, Minnesota* (Oct. 1987) [hereinafter Bortz Study]. This study was prepared by one of the experts who testified for the city of St. Paul in the *Nor-West* case, and formed the basis for his conclusions on economic feasibility. Malarkey-Taylor Research, *Economic Analysis of Cable System Overbuilds* (Jan. 1987) [hereinafter Malarkey-Taylor Research]. *See generally* Touche Ross & Co., *Metro-Dade Report on Overlapping Cable Franchise Study* (Oct. 1987) [hereinafter Touche Ross Report]. Touche Ross was engaged by Dade County in 1987 to conduct a study of the effects of granting overlapping franchises for cable television service in the county.

78 Malarkey-Taylor Research, *supra* note 77, at i.

79 *Id.*

80 P. SAMUELSON & W. NORDHAUS, ECONOMICS 522 (12th ed. 1985).

81 Malarkey-Taylor Research, *supra* note 77, at iv ("An overbuild may be economically viable, for example, in a high density, high cable demand market, where franchise and other requirements do not mandate a state-of-the-art system.").

82 *Id.* at 8.

ices are likely to be fewer and of poorer quality with an overbuild than with a single operator.[83]

Although one may safely presume that cable possesses "natural monopoly" characteristics as a distribution medium in the vast majority of service areas, whether it is a natural monopoly in any given area requires a market-specific inquiry. Economic feasibility of an overbuild must be a market-by-market determination.[84] While broad-ranging statistical data is not available to establish conclusively whether allowing the existence of competing cable systems within the same area has led to consumer benefits such as lower prices, superior services, or more rapid innovation, specific case examples indicate that it has not.[85] The case examples suggest that competition in an urban new build cable system does not present enhanced benefits for consumers.

3. Results of Survival of Single Cable Firms

As of 1987, in 49% of the jurisdictions where actual overbuilds had occurred, simultaneous or sequential competitive entry ultimately resulted in the survival of a single cable operator.[86] Insufficient evidence exists to determine whether survival of a single firm has an impact on prices paid by subscribers. How-

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[83] *Id.* at iii-iv. *See generally* Bortz Study, *supra* note 77; Touche Ross Report, *supra* note 77, at 23-24 (study included analysis of physical capacity and economic demand for an additional cable system in the county, as well as evaluation of such "overbuilds" that existed elsewhere).

[84] To the extent that competition has occurred, the success or continued existence of the overbuild may be explained by the absence of any need to obtain financing for the construction and operation of the system. For example, Telesat, the most active overbuild cable operator in the country, enjoys the benefits of its position as a wholly-owned subsidiary of FPL Group, a Fortune 500 Company with assets in excess of $9 billion. Whenever Telesat experiences revenue shortfalls in the operation of its overbuild systems, it can, unlike many other operators, look to its parent corporation to make up those shortfalls to ensure its continued existence. *Nor-West*, CV 3-83-1288, at Tr. 327-32 (testimony of Cushing).

[85] For example, in Phoenix, Arizona, the franchising authority issued multiple franchises and allowed simultaneous construction. Two cable companies attempted to engage in head-to-head competition and began construction of their systems at the same time. This simultaneous construction resulted in a "race to build" that caused numerous problems, including hundreds of complaints, consumer confusion, disruption due to multiple crews building simultaneously, and many instances of property damage. *Id.* at Tr. 3758-59 (testimony of Lindauer) and at Tr. 4938-46, 4963-64 (testimony of Terry Parker, Cable Communications Officer, Phoenix, Arizona). The overbuild that occurred in Phoenix did not result in any increase in market penetration. In fact, overall market penetration was in the low 30% range. The systems were not constructed in an orderly, well-engineered fashion and were subsequently plagued by errors. The programming services offered by both companies were virtually identical and the competition did not lead to lower prices for subscribers. *Id.* at Tr. 3758-59 (testimony of Lindauer).

[86] Analysis of these results led one expert to conclude that "it is unlikely that competition can be sustained in the long term, not impossible, but unlikely." *Id.* at Tr. 3889-90 (testimony of Jay Smith, a partner at Touche Ross, who supervised preparation of firm's cable industry overbuild studies).

ever, while economic theory suggests that consumer prices may initially increase upon termination of competition, allowing the surviving operator to recoup losses it incurred during the period of competition should not, on average, increase to a point higher than that which would have existed if no overbuild occurred.[87] The negative impact of a rate increase is counterbalanced by the increase in total social welfare.[88]

Additionally, eliminating competition may reduce visual clutter caused by duplicating wires, terminate customer confusion regarding installation and service, and reduce promotional service or billing costs. It may also provide financial support for better service and capital expenditures for system upgrades and enhance the survivor's ability to fulfill commitments with respect to public access or other community services. Finally, eliminating competition may result in a greater diversity of commercial and non-commercial programming.[89]

4. Allowance of Competing Cable System Mergers

The FCC asks whether it should recommend to Congress that competing systems should not be allowed to swap or merge.[90] No hard data exists regarding the extent to which franchising authorities in communities with competing cable systems have allowed or encouraged such competing systems to merge or divide their territories. Presumably, to the extent this has occurred, it has been allowed or encouraged to obtain better service, assurances of improved plant and equipment, and support for public, educational, and governmental access.

There is no need to modify the Cable Act to establish structural rules, encourage antitrust actions, or prevent mergers among cable systems competing in the same local market. There is no public interest served by mandating competition until only one operator survives, as would be the case in most markets. Moreover, the antitrust laws already forbid agreements that enable competing cable systems to divide markets and avoid competition against each other in localities where two or more systems are authorized.[91]

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[87] Touche Ross Report, *supra* note 77, at 40.

[88] Bortz Study, *supra* note 77, at 25-26.

[89] Touche Ross Report, *supra* note 77, at 41.

[90] *See* Notice of Inquiry, *supra* note 1, at 366.

[91] Sherman Antitrust Act, 15 U.S.C. § 1 (1988).

5. Reasons Franchising Authorities Authorize Single Franchises

Since competition between two cable operators in many, if not most, markets will be short-lived, if it occurs at all, given the natural monopoly characteristics of cable, franchising authorities have a number of interests that are best served by issuing single franchises. Installation of a cable system requires allocation of limited space on, over, and under public rights-of-way. It also involves the physical disruption of public and private property and environmental issues, including aesthetic concerns. By selecting only one operator, the franchising authority can allocate the limited public right-of-way space and further minimize disruption and environmental problems. Moreover, by selecting a single cable system, a franchising authority can insure that the operator has sufficient revenues to provide service to all of the residents in the franchise area and to provide access channels for public, educational, and governmental uses, as well as other municipal uses.

B. *Eliminating the Franchise Requirement for Video Dial Tone Service*

The FCC has also asked for comments on NTIA's "video dial tone" proposal.[92] Under this plan, the Cable Act would be amended to allow companies to lease common carrier transmission facilities from local telephone companies to provide an alternative multichannel video service without having to obtain a local franchise. This proposal is entirely contrary to the basic scheme of local franchise decision making established by the Cable Act. It would also be unfair to cable operators who would have to compete with these unregulated entities. Under the NTIA proposal, programmers who used the common carrier "video dial tone" system would incur no 5% franchise fee, no obligation to provide educational, governmental, or leased access channels and facilities to support their use, no equal employment opportunity requirements, and none of the other local franchise commitments cable operators must acquire.

Telephone companies today may legally build and own common carrier video distribution facilities. The Cable Act's cross-

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[92] Notice of Inquiry, *supra* note 1, at 366. This proposal was first made in a seminal 1988 report on cable by the Commerce Department's National Telecommunications and Information Administration ("NTIA"), then headed by current FCC Chairman Alfred Sikes. *See generally* United States Dep't of Commerce, Video Program Distribution and Cable Television: Current Policy Issues and Recommendations, NTIA Report 88-233 (June 1988) [hereinafter NTIA Report].

ownership prohibition affects only a local telephone company's ability to offer cable service directly to the public or engage in programming.[93] Telephone companies may build separate coaxial or fiber optic systems for video delivery, or integrated voice and video broadband plant. There are a number of telephone companies that have provided leased broadband network services to cable operators in communities such as Palo Alto, California, Cleveland, Ohio, and Washington, D.C.

There are only two requirements for telephone company video distribution services. First, the telephone company must demonstrate the need for construction of the broadband channel lease facilities service through the filing of a section 214 application with the FCC.[94] Second, any entity proposing to provide programming over such a broadband system built by the telephone company must obtain a franchise.[95] This latter condition was a conscious decision made by Congress since it is the programmer that will select the programming, set tiers of service and rates, and make the other decisions that the franchise authorities will have to review in determining whether to grant renewal. If telephone companies believe that providing video services over integrated broadband networks makes economic sense, they should be able to convince programmers to apply to municipalities for franchises.[96]

Another serious policy problem with the NTIA proposal is that a common carrier channel tariff-based regulatory structure, without municipal franchising scrutiny, may drive out programming for minority interests. Cable operators currently have a number of incentives to propose the most diverse possible pack-

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93 *See* Report of Comm. on Energy and Commerce, Cable Franchise Policy and Communications Act of 1984, H.R. REP. No. 934, 98th Cong., 2d Sess. 57 (1984), *reprinted in* 1984 U.S. CODE CONG. & ADMIN. NEWS 4655, 4694 ("[N]othing in [the Cable Act] is intended to prevent a common carrier from constructing . . . a local distribution system that is capable of delivering video programming and other communications or information services . . . .").

94 47 U.S.C. § 214 (1982). *See, e.g.*, Chesapeake and Potomac Tel. Co., 57 Rad. Reg. 2d (P & F) 1003 (1985); Ohio Bell Tel. Co., 1 F.C.C. Rcd. 942 (1986).

95 This is because of the interrelationship between section 621(b)(1) of the Cable Act, which states that a "cable operator" may not provide "cable service" without a franchise, and the broad definitions of "cable operator" and "cable service" in the Cable Act. *Compare* Cable Act, § 621(b)(1), 47 U.S.C. § 541(b)(1) (Supp. V 1987) *with* Cable Act, § 602, 47 U.S.C. § 522.

96 In Cerritos, California, where the Commission granted a waiver to GTE for a local telephone company-cable joint venture, the entity that is providing the programming on that telco-built facility, Apollo Cablevision, did obtain a municipal franchise from the city. General Tel. Company of California, FCC Nos. W-P-C-5927, W-P-C-6250, 4 F.C.C. Rcd. 5693 (1989), *appeal pending sub nom.* NCTA v. FCC, No. 89-1517 (filed Aug. 28, 1989).

ages of programming. Cable operators wish to maximize the number of consumers who will subscribe to their service. To serve these demands, programming suppliers try to come up with unique niche programming for children, minorities, the elderly, and other groups, to add to the diversity of the overall package. Such diversity has also been encouraged by local franchising authorities in selecting from among competing proposals.

The NTIA proposal for the restructuring of video service delivery could dramatically undermine these incentives, creating a real possibility that delivery of programming will become fragmented. If channel capacity is sold to individual programming suppliers based on the same tariff for each channel and made available on a channel-by-channel basis, a premium will be placed on those types of programming services that make the highest profit on a stand-alone basis, rather than niche programming that is attractive as part of an overall package. This inexorable pressure may please economists, since it would result in the presentation of only the "highest value" programming to the largest number of viewers. But it would destroy the "externalities" of the current system that bear a high social value. For example, niche programs for minority group interests, one such externality, may not be able to afford a uniform tariff.

Would the FCC allow a carrier to give a "social discount" based on the type of programming offered? Will discounts be allowed for multichannel packages? Will the FCC set rates, or consider this area "competitive" and therefore not subject to tariff review or will it allow the states to set tariffs? What will be the rate for broadcast television stations as opposed to public television stations? This proposal could undo the diversification already created by cable, rather than foster additional diversification in home video.

C. *Requiring the Award of Two or More Franchises*

The FCC notes in its Inquiry that section 621(a) of the Cable Act provides that a "franchising authority may award . . . 1 *or more* franchises within its jurisdiction," and asks whether this provision should be amended to require two or more franchises to be awarded.[97] The significance of the existing Cable Act provision is that it grants a municipality the power to award as many nonexclusive franchises as it deems appropriate. The Cable Act

[97] Notice of Inquiry, *supra* note 1, at 366 (quoting Cable Act § 621, 47 U.S.C. § 541 (Supp. V 1987)) (emphasis added).

places no barriers in front of cities that wish to award a second or third cable franchise.

The Cable Act, however, also recognizes that such municipal decisions must be made based on uniquely local factors which include the availability of pole and conduit space, the physical disruption and environmental impact that construction of a second system would cause, as well as other health and safety considerations.[98] As discussed above, available evidence also suggests that "overbuilds" may not be economically feasible in many markets, particularly where construction costs are high and there is good off-air reception of local broadcast stations.[99]

In view of the historical record of overbuild failures, it is incomprehensible that the FCC could consider a recommendation which would require that two or more cable franchises be awarded in every city and town in the United States. Cities that experience poor quality cable service already have every incentive to invite competition from other cable providers.[100] Since many communities may only be able to support one cable system, cities should be able to establish universal service requirements. Although the law remains unsettled in this area, courts have upheld the constitutionality of such requirements.[101] Cities should also be allowed to establish community-wide public, educational, governmental, and leased access requirements.[102]

If section 621(a)(3) of the Cable Act were amended to allow a second cable operator to serve selected neighborhoods in a franchise area, as opposed to the entire community, economic redlining would occur. Neighborhoods with more favorable demographics might have a choice of cable providers whereas poorer inner city neighborhoods would not. To the extent that the second entrant would be allowed to skim cream in this manner, it would undermine the financial stability of the incumbent operator, thereby reducing its ability to responsibly serve the entire community. Local origination and public access would be

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98 Cable Act, § 621, 47 U.S.C. § 541.

99 *See generally* Touche Ross Report, *supra* note 77.

100 This is precisely what has happened in West Tennessee, where a group of cities, disenchanted with Multivision, the cable franchisee, recently sought other bids. Because off-air reception in the service area was poor and because construction was relatively inexpensive, due to the fact that most of the plant is aerial, a second cable company has entered the market.

101 *See, e.g.*, Preferred Communications, Inc. v. City of Los Angeles, No. CV 83-5846 (CBM) (C.D. Cal. Jan. 5, 1990).

102 Such access requirements have also been upheld, despite some decisions to the contrary. *See* Erie Telecommunications, Inc. v. City of Erie, 659 F. Supp. 580 (W.D. Pa. 1987), *aff'd on other grounds*, 853 F.2d 1084 (3d Cir. 1988).

among the first victims of such an arbitrary licensing scheme.[103]

1. To What Extent Can Cities Constitutionally Limit Cable Market Entry?

The Supreme Court has yet to decide what first amendment standard to apply to the regulation of cable television. The Court chose to defer that question in *City of Los Angeles v. Preferred Communications, Inc.*,[104] remanding the case for the development of a factual record elucidating "the present uses of the public utility poles and rights-of-way and how [the disappointed franchise applicant] proposes to install and maintain its facilities on them."[105] In remanding the case, the Court declined to articulate any standard by which to measure the first amendment rights of cable operators, beyond noting that some kind of balancing would be required.[106] Despite contrary rulings by federal district courts,[107] there has been no authoritative holding by a federal appellate court, nor by the Supreme Court, since this issue was first addressed by the *Preferred* Court in 1986. Lower courts have been left to speculate as to the proper standard. Even when courts agree on a standard, they have disagreed on its application.

Municipal regulation of cable operators should be upheld under whatever standard the Supreme Court determines should be applied. Upholding municipal regulation would allow municipalities to continue to award single, non-exclusive franchises for

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[103] In view of these concerns, several states have enacted legislation that would require second franchisees to meet the same regulatory requirements as incumbent cable operators. Florida, California, Minnesota, Illinois, Tennessee, Oklahoma, and New Hampshire are examples of states that have enacted such new legislation. These "level playing field" laws are designed to prevent unfair competition from those who are unwilling to compete under the same set of rules.

[104] 476 U.S. 488 (1986).

[105] *Id.* at 495.

[106] *Id.* ("[W]here speech and conduct are joined in a single course of action, the First Amendment values must be balanced against competing societal interests.").

[107] The district court in the remand of the *Preferred* case, for example, recently ruled on summary judgment motions that Los Angeles' selection of a single operator per franchise area was unconstitutional under the *O'Brien* test. Although the city's interests were "substantial," the "one operator requirement [was] too restrictive a means of carrying out these interests." Preferred Communications, Inc. v. City of Los Angeles, No. CV 83-5846 (CBM) (C.D. Cal. Jan. 5, 1990), Memorandum Order at 16. Under the *O'Brien* test,

> a government regulation is sufficiently justified [1] if it is within the constitutional power of the Government; [2] if it furthers an important or substantial governmental interest; [3] if the governmental interest is unrelated to the suppression of free expression; and [4] if the incidental restriction on alleged First Amendment freedoms is no greater than is essential to the furtherance of that interest.

United States v. O'Brien, 391 U.S. 367, 377 (1968).

given service areas. The decision as to whether one or more than one franchise would be awarded must be based on a market-specific inquiry in which the governing body considers factors such as prospective disruption, environmental impact, physical limitations, and economic demand for cable in the service area. Whether a single franchise is preferable in any given area is a decision that must be reserved to the local franchising authority. Municipalities should have the flexibility to limit the number of franchises, including limiting that number to one, where circumstances dictate.

2. Imposition of Identical Requirements on Subsequent Cable Market Entrants

The FCC also seeks input on whether a franchising authority may lawfully impose upon a subsequent cable operator that it permits to enter the market the same service obligations and franchise requirements that it imposed on the original franchisee.[108] It would seem logical that the franchising authority should be able to impose any and all constitutional requirements on all subsequent entrants. Indeed, to impose fewer restrictions would invite an equal protection challenge from the original operator.[109]

Presently, several states have laws on their books providing that subsequent franchisees in a given service area meet the same requirements as the original franchisee.[110] A challenge to such a law on first amendment grounds is unlikely to succeed.[111] The economic realities of the cable business are such that, at least at present, multiple franchises in most markets are unlikely to endure.[112] A system that allowed a cable operator to enter a given market on its own terms, regardless of the requirements imposed on an existing operator, would promote chaos.

108 Notice of Inquiry, *supra* note 1, at 367.

109 Any subsequent franchise subject to lesser restriction or fewer requirements than the initial franchise, *e.g.*, providing free drops to municipalities or local access channels, would put the original franchise at a significant competitive disadvantage. Such disparate treatment of indistinguishable service providers would raise equal protection issues.

110 *See supra* note 103.

111 Subsequent franchises may raise first amendment questions regarding the imposition of requirements. Such regulations are "reasonable," "content neutral," and "not an effort to suppress expression." *See* Perry Educ. Ass'n v. Perry Local Educators' Ass'n, 460 U.S. 37 (1983).

112 Due to the large capital investment required to run cable and operate systems, each franchise must attain significant subscribership. Splitting the market, in general, is not economically feasible.

D. *Direct Broadcast Satellites*

Existing competitors to cable such as broadcast, VCRs, and C-Band home dishes apply constant pressure on cable's ability to price its product. But the existence of other potential entrants serves as another significant control on price. The potential of DBS provides this restraint,[113] especially since announcements in the first two months of 1990 have raised the prospect of DBS becoming one of the more viable new outlets for video programming.[114] These DBS developments are concrete examples of the impact potential competitors have on the cable industry. A year ago, there was no certainty that DBS would reach the level of development necessary to act as an actual competitor to cable, terrestrial broadcasters, and other video distributors, although this satellite technology demonstrated significant potential. Today, however, there is no question that DBS will compete vigorously in the market.[115]

The Department of Justice Merger Guidelines include potential entrants in its definition of a relevant market.[116] These

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[113] DBS, which requires no stringing of cable and only a briefcase-sized flat or parabolic dish to receive its signal, has the potential of reaching rural customers presently unserved by cable as well as urban dwellers who may be attracted to the convenience of the small receiving dish. Existing backyard satellite dishes, which unlike their DBS counterparts have demanding space and cost requirements, are expected to show an 11% increase in the number of sales nationwide in 1990. *Execs Predict Strong 1990 Sales; Say TVRO Faces Challenges*, Satellite Business News, Jan. 24, 1990, at 9.

[114] *See Hughes, NBC, Murdoch And Cablevision Launch $1-Billion DBS Consortium*, Communications Daily, Feb. 22, 1990, at 1 [hereinafter *Hughes, NBC*].

[115] The GE Americom K Prime Partners project, a medium-powered DBS system in which nine cable operators are participants, plans to offer seven superstations and three pay-per-view channels. This programming can be picked up on a dish measuring only about one meter in diameter. Stratton, *MSO Group Beaming Up in Ku-Band Enterprise*, Multichannel News, Feb. 12, 1990, at 1, col. 1, and at 38, col. 1. Additionally, the Hughes Communications "Sky Cable" project has signed on as partners GE/NBC, News Corporation of America and Cablevision Systems Development Corporation. These video communications veterans anticipate an investment of $1 billion and expect the potential for 108 channels beginning in 1993. *Hughes, NBC, supra* note 114, at 1. Other companies besides Hubbard have been steadily experimenting with the technology and potential of DBS and have brought it to its present level of near-readiness. No less than five companies claimed the ability last fall to imminently launch a direct broadcast satellite service. *The Race to Launch New DBS Services*, Satellite Business News, Nov. 29, 1989, at 1, 22. Last year, the FCC granted new permits to Continental Satellite Corporation (not affiliated with Continental Cablevision), EchoStar Satellite Corporation, Directsat Corporation, and DBSC. Continental Satellite Corp., 4 F.C.C. Rcd. 6292 (1989). The FCC also granted additional channels to four earlier DBS applicants. *Id.* The high profiles and previous broadcast and cable experience of both sets of newcomers to the DBS industry will certainly impact the home video market. *See Cable-GE Partnership Revives DBS*, BROADCASTING, Feb. 19, 1990, at 64 (Cable-GE revives DBS for all potential participants). Stanley Hubbard of Hubbard Broadcasting, another DBS applicant, remarked that to the extent that K Prime proves that satellite broadcasting is "feasible . . . it makes our project all the more attractive." *Id.* at 65.

[116] Department of Justice, 1984 Merger Guidelines, Antitrust Division Manual, § 2.1, at 7-32 (1990).

are firms that could easily and economically sell the relevant product within one year in response to a small but significant price increase.[117] DBS clearly falls into this category. Because of the latest infusion of capital into this technology and the growing number of interested investors, DBS could become a significant player in the video industry. DBS has emerged as a lightly regulated competitor without any local franchise fees to pay, no required access channels or local origination obligations, no free drops to municipal buildings or required two-way plant. DBS would find few barriers to entry and could have a substantial effect on the video industry. Cable operators must, therefore, price competitively and provide high quality programming to maintain their customer base.

The potential for rapid change in the cable industry, due in large part to recent capital investment, may be inhibited by new regulations on cable which could hamstring its ability to compete. This is a special concern in an industry where, to date, free market forces have successfully encouraged growth and diversity. Reregulation of cable could only serve to stifle its growth and ability to advance and invest and leave it weakened to challenge new competitors who would share none of the same regulatory burdens.

E. *Wireless Cable*

"Wireless cable" or MDS uses microwave radio channels rather than coaxial cable to deliver video programming to the home. MDS, originally a one-channel service, has experienced slow but steady growth since its progeny MMDS was created in 1983.[118] In February, 1990, the FCC released a Notice of Proposed Rulemaking aimed at increasing MDS competitiveness by simplifying the FCC's requirements and restrictions applicable to MDS operators.[119] The FCC proposed to amend its often conflicting MDS, OFS, and ITFS rules to make it easier for "wireless cable" operators to collectively use these services to form multiple video channel systems.

Two conclusions can be drawn from this latest Commission

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117 *Id.* at § 2.21, 7-35.

118 *See* Report and Order in Gen. Dkt. No. 80-112, 94 F.C.C.2d 1203 (1983). It is available in such cities as Cleveland, New York, Detroit, and Washington and, according to the Wireless Cable Association, today reaches 300,000 homes. *Wireless: Going Head to Headend with Conventional Cable*, BROADCASTING, Sept. 18, 1990, at 62.

119 Notice of Proposed Rulemaking: Amendment of the Commission's Rules Governing Use of the Frequencies in the 2.1 and 2.5 GHz Bands, Gen. Dkt. No. 90-54, FCC 90-60 (Feb. 22, 1990).

action that bear on the FCC's Cable Inquiry. First, over-regulation in a competitive industry is inefficient and restricts development. Second, MDS has been a potential competitor of the cable industry in the past and is expected to be a formidable competitor in the future. The FCC in its MDS Notice recognizes that rapid change in the video distribution marketplace was unanticipated and its prior regulations inhibited dynamic change.[120] The FCC should recognize from this experience that predictions of the future development and direction of the video distribution industry are often wrong. In the changing commercial environment in which cable, broadcasters, home dishes, and VCR outlets as well as DBS, MMDS, and other technologies compete for viewers, the Commission should allow marketplace mechanisms to respond.

The FCC calls MDS a "viable alternative to cable television service,"[121] noting that "while MDS's competitive potential is, as yet, largely unrealized, even the prospect of credible competition can have a salutary effect on existing service providers and thus redound to the benefit of the public."[122] As noted in the above discussion of DBS,[123] this is basic antitrust policy endorsed by the Justice Department. Even where a potential competitor does not have the ability to immediately provide the desired service, it acts as a restraint on price and a spur to quality. Should prices rise above a competitive level or quality drop below state of the art, investment will flow from the old technology into the new technology.[124]

In its Notice of Inquiry, the FCC asks whether there are any local requirements that impede MMDS development.[125] In fact, the irony is that all of cable's competitors, including MMDS, are free from the kinds of strict franchise regulations cable meets and the franchise fees that cable pays. MMDS operators do not have to obtain municipal franchises, pay a percentage of their gross revenues to cities and states, provide public, educational, governmental, or leased access channels, free drops to schools or municipal buildings, or meet local or FCC equal employment opportunity standards. Thus, the playing field is hardly tilted

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120 *Id.*
121 *Id.*
122 *Id.*
123 *See supra* notes 116-17 and accompanying text.
124 *See, e.g.*, Bailey & Baumol, *Deregulation and the Theory of Contestable Markets*, 1 YALE J. REG. 111 (1984); BAUMOL, PANZAR & WILLIG, CONTESTABLE MARKETS AND THE THEORY OF INDUSTRY STRUCTURE 222 (1982).
125 Notice of Inquiry, *supra* note 1, at 368.

against MMDS or, for that matter C-Band satellites and DBS, which share the same advantages.

IV. Access and Signal Carriage

A. *Must-Carry and Channel Positioning*

As part of its Cable Inquiry, the FCC returns to an issue filled with constitutional uncertainty and a history of hard fought legal battles concerning the degree to which a cable operator can be forced to carry a local broadcaster's signal.[126] NCTA has for years made serious efforts to achieve a reasonable compromise with broadcasters on a constitutional must-carry statute. After years of insistence by broadcasters that cable operators provide them carriage free-of-charge, however, a proposal has now been released that would require cable operators to pay for carrying a broadcast station's programming.[127] This suggestion is extremely objectionable to cable when cable carriage has dramatically expanded the viewing audience of many independent, particularly UHF, stations.

Independent television has enjoyed significant growth in the 1980s.[128] This is due, in large part, to the cable industry's willingness to carry and thereby drastically increase the audience for UHF stations that would otherwise reach a limited number of viewers.[129] Despite the fact that there has not been any effective governmental must-carry requirement in nearly five years,[130] the majority of cable operators have voluntarily honored the terms of a joint industry compromise that would require cable operators

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126 *Id. See* Quincy Cable TV, Inc. v. FCC, 768 F.2d 1434 (D.C. Cir. 1985), *cert. denied*, 476 U.S. 1169 (1986); Century Communications Corp. v. FCC, 835 F.2d 292 (D.C. Cir.), *clarified*, 837 F.2d 517 (D.C. Cir. 1987), *cert. denied*, 486 U.S. 1032 (1988).

127 NAB News Release, *Television Broadcasters Seek Payment from Cable for Carriage of Signals* (Jan. 15, 1990).

128 *See supra* note 4.

129 Jack C. Clifford, Vice-President, Broadcasting, for Providence Journal Communications, who oversees that company's affiliate stations, independent stations, and cable franchises, recently noted that "Cable made UHF competitive." Grillo, *Independent TV Stations Seek Peace with Cable*, Multichannel News, Feb. 12, 1990, at 4, col. 1. He also argues that "[m]ust-pay will only drive a further wedge between cable and broadcasting." *Id.*

130 The FCC's original must-carry rules were invalidated in 1985 in *Quincy*, 768 F.2d 1434 (D.C. Cir. 1985), *cert. denied*, 476 U.S. 1161 (1986). In that decision the D.C. Circuit:

> Until [the Commission] establishes a baseline for its general objective of preserving free, community-oriented television—measured by the number of local broadcast stations in the community, the amount of local programming, or any other criterion within its discretion to choose—we simply cannot know whether the rules are adequately tailored to pass constitutional muster.

Id. at 1461.

to carry most local broadcast television stations.[131]

1. Lack of Broadcast "Localism"

In those instances where cable operators have dropped a local broadcast station, the FCC needs to examine the degree to which the station aired local programming. In 1985, NCTA surveyed UHF stations that had recently gone on the air. These independents devoted less than 2% of their broadcast time to local news and community affairs programming.[132] On the other hand, cable operators are providing increasing amounts of local origination programming in addition to local public access channels.[133] Cable will spend an estimated $250 million on local programming in 1990.[134] Broadcasters, never satisfied, are now complaining that this too is unfair competition.[135]

If a non-carried station does little for "localism" and carries only nationally delivered sitcoms and movies, there is no reason that such a station should be afforded preference for a cable channel over CNN, BET, or any other cable satellite service. Broadcasters, however, are not just seeking to require cable operators to carry their national programming. Broadcasters want to require cable operators to purchase this programming. The National Association of Broadcasters ("NAB") has proposed that Congress enact a new must-carry provision that would require that any cable operator who chooses to carry even one local tele-

[131] After *Quincy*, a compromise was reached between representatives of the cable operators and broadcast industry. This compromise, with some additional Commission "tweaking" was also struck down by the courts as unconstitutional. Century Communications Corp. v. FCC, 837 F.2d 517 (D.C. Cir. 1987).

In 1988, NCTA commissioned the consulting firm of Price-Waterhouse to survey the extent to which local broadcast stations are carried on cable systems and the extent to which their channel assignments have changed since the FCC's last must-carry rules that resulted from the compromise. According to this study, 98% of the broadcast stations that qualified for carriage under the last must-carry rules were carried at the time of the survey, despite the absence of a legal requirement to do so. *Oversight of Cable TV: Hearings Before the Subcomm. on Communications of the Senate Comm. on Commerce, Science, and Transportation*, S. Hrg. 101-464, 101st Cong., 1st Sess. 84 (Nov. 16-17, 1989) [hereinafter *Oversight of Cable TV*] (testimony of James P. Mooney, President, NCTA).

[132] Remarks of James P. Mooney before the Washington Metropolitan Club (Jan. 23, 1990).

[133] Some are developing local news and information channels. *See Cable Can Win The Local Station's Game*, MSO, Jan. 1990, at 6 (describing local cable news operators in Council Bluffs, Iowa and Owensboro, Kentucky); Ziegler, *New Era For Local Programming*, Cable World, Jan. 8, 1990, at 3 [hereinafter Ziegler] (discussing local cable news and talk shows in Ithaca, New York, Long Beach, California, and Orange County, California).

[134] Ziegler, *supra* note 133, at 3.

[135] When ATC's Rochester, New York system started a local channel, WRGC, that became active in acquiring syndication rights and programming local news, sports, children's, and community affairs programming, INTV sent letters to Congress and the FCC seeking to halt this competition for true "localism."

vision station must carry all local stations in the market and pay a percentage of the operator's basic revenue to these broadcasters. This proposal has obvious constitutional problems.[136] But even apart from these, the NAB plan is anti-consumer, anti-competitive, and unfair.

Cable operators do not have unlimited channels. As any local merchant must, cable operators need to cull through the wide variety of potential products to put the most attractive and unique in the limited "showcase" space available. Must-carry and channel positioning requirements, however, require cable operators to put broadcast station programming on the air or on particular channels in place of programming for which consumer demand has been demonstrated. It is as if the government required a newspaper to display a particular column on a particular page. If cable operators cannot editorially select and position the optimum channel viewings from among over-the-air broadcasters and cable-specific programming, they will likely lose revenues.

2. Payment for Broadcast Carriage

Not satisfied with imposing this burden on cable operators, broadcasters are also demanding that operators pay for the stations that they might not choose, but now would be required to carry. Raising cable rates to meet the broadcaster's financial demands could result in consumer objection and a decline in subscriptions. This is a winning proposition for the broadcasters and a losing proposition for cable and consumers.[137]

Taken together, the "must-carry/must-pay" proposal of NAB and the INTV proposal for preferential channel positioning leave cable operators in a situation in which they can neither choose their own merchandise nor where in their store to display it. In the post-*Quincy* 1986 joint industry agreement, cable opera-

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136 The Supreme Court has recognized first amendment implications of cable regulation noting that cable operators exercise editorial discretion in selecting which services to provide subscribers. *See* City of Los Angeles v. Preferred Communications, Inc., 476 U.S. 488, 494 (1986). In Quincy Cable TV, Inc. v. FCC, 768 F.2d 1434, 1452 (D.C. Cir. 1985), *cert. denied*, 476 U.S. 1161 (1986), the D.C. Circuit specifically struck down regulations requiring cable operators to carry local broadcast channels as limiting "the operator's otherwise broad discretion to select the programming it offers its subscribers." *Id.*

137 A glance at one example of what cable operators in the greater Boston area could be required to carry and the programming to which cable operators might have to give up is illuminating. The Boston Globe's March 1, 1990 prime time television listings for Boston area independent television stations and several basic channels show that with the exception of Channel 56, WLVI-TV, not one of the Boston area independent stations offers a nightly prime time local news or public affairs program. Rather, they carry programs, primarily sitcoms and movies, that are similar in nature to those found on Lifetime, USA Network, TNT, and other cable channels.

tors and broadcasters agreed that stations could be carried on any channel or frequency so long as qualified stations[138] were carried on the lowest-priced, separately available tier of service offered by the cable system.[139] In the fall of 1989, NCTA supported Senator Inouye's call for a compromise where the status quo would be maintained until the FCC developed rules for adjudicating channel position disputes.

3. "Public Trustee" Status of Broadcasting

The FCC in other contexts has argued the inherent inequality of preferential treatment for one medium over another. In the FCC's inquiry into the continued viability of the Fairness Doctrine, the Commission stated that "[g]iven that the print and broadcast media compete in the information distribution marketplace and in the business marketplace for consumers and advertising revenues, it may be inappropriate, indeed, unfair for the government to assume the role of handicapper of one media *vis-a-vis* another."[140] Yet, the must-carry rules are blatantly preferential. Broadcasters are guaranteed channel space regardless of the quality of their programming or consumer demand for it.

Historically, broadcasters received preferential treatment from the FCC because broadcast regulation was based on the concept that in exchange for the use of spectrum space broadcasters would provide service as a public trustee.[141] This "public trustee" regulatory scheme, however, has been given only lip service by most Commissions.[142] The FCC has never specified or offered percentage guidelines as to what constitutes a "reasonable" or "substantial" amount of local and informational pro-

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138 A qualified station is one which, among other things, "has achieved a 2 percent share of viewing and a 5 percent net weekly circulation in non-cable homes, by county." Amendment of Part 76 of the Commission's Rules Concerning Carriage of Television Broadcast Signals by Cable Television Systems, MM Docket No. 85-349, 1 F.C.C. Rcd. 864, 889 (1986).

139 *Id.* Statistics submitted by NCTA to the FCC in 1988 showed that 91% of cable operators continued to carry stations in the same position as before the compromise was invalidated by the court. *Oversight of Cable TV, supra* note 131, at 85 (statement of James P. Mooney, President, NCTA). Of those that have changed, 80% were repositioned to cable channels equal to or lower in number than the station's FCC channel assignment. *Id.* (lower positions presumed to be more desirable to the broadcasters involved).

140 Inquiry into the General Fairness Doctrine Obligations of Broadcast Licenses, 49 Fed. Reg. 20,317, 20,327 (proposed May 14, 1984).

141 *See* H. Geller & D. Lampert, *Charging for Spectrum Use*, in BENTON FOUNDATION PROJECT ON COMMUNICATIONS & INFORMATION POLICY OPTIONS (1989) [hereinafter Geller & Lampert].

142 Geller, *Broadcasting and the Public Trustee Notion: A Failed Promise*, 10 HARVARD J.L. & PUB. POLICY 87 (1987).

gramming.[143] Creating such FCC guidelines might, in fact, provide a constitutionally permissible must-carry rationale.

FCC decisions, chipping away at the concept of broadcasters as public trustees, have severely undercut the argument that special treatment should be afforded them in carriage or placement decisions. In 1981, the Commission replaced the license renewal process with postcard renewal applications.[144] In 1982, the FCC eliminated rules requiring a licensee to hold its license for three years before transferring it.[145] In 1984, the Commission revised the multiple ownership rules allowing an entity to own up to 12 stations nationally.[146] In 1984, the FCC also removed advertising limits, news and public affairs programming requirements, and ascertainment obligations for commercial television licensees.[147] The next year the Commission removed other operational regulations.[148] In 1987, the Commission eliminated the "Fairness Doctrine," which attempted to assure coverage of opposing points of view on issues of public concern.[149]

At the same time, FCC deregulation of broadcasters cut wide and deep, cable operators are bound by the Cable Act to provide for the public welfare in a variety of ways. Cable operators are required to pay the cities by which they are franchised up to 5% in gross revenues.[150] They are required to provide public, government, educational, and leased access channels over which the cable operator may not exercise editorial control.[151] Cable operators have the same equal time requirements for political candidates as broadcasters,[152] as well as strict statutorily based equal

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143 Geller & Lampert, *supra* note 141, at 12.

144 Revision of Application for Renewal of License of Commercial and Noncommercial AM, FM, and Television Licensees, 46 Fed. Reg. 26,236 (1981), *aff'd. sub nom.* Black Citizens for a Fair Media v. FCC, 719 F.2d 407 (D.C. Cir. 1983), *cert. denied*, 467 U.S. 1255 (1984).

145 Amendment of Section 73.3597 of the Commission's Rules, 52 Rad. Reg. 2d (P & F) 1081 (1982), *modified*, 99 F.C.C.2d 971 (1985).

146 Amendment of Section 73.3555 of the Commission's Rules Relating to Multiple Ownership of AM, FM, and Television Broadcast Stations, 100 F.C.C.2d 17 (1984), *modified*, 100 F.C.C.2d 74 (1985).

147 Report and Order in MM Docket No. 83-670, 98 F.C.C.2d 1076 (1984), *recon. denied*, 104 F.C.C.2d 358 (1986), *aff'd in part and rev'd in part sub nom.* Action for Children's Television v. FCC, 821 F.2d 741 (D.C. Cir. 1987).

148 *See, e.g.*, Elimination of Unnecessary Broadcast Regulation, 57 Rad. Reg. 2d (P & F) 913, *recon. denied*, 58 Rad. Reg. 2d (P & F) 864 (1985), *aff'd sub nom.* Telecommunications Research and Action Center v. FCC, 800 F.2d 1181 (D.C. Cir. 1986); Elimination of Unnecessary Broadcast Regulation, 50 Fed. Reg. 6246 (1985).

149 Syracuse Peace Council v. Television Station WTVH Syracuse, New York, 2 F.C.C. Rcd. 5043 (1987), *recon. denied sub nom.* Syracuse Peace Council v. FCC, 867 F.2d 654 (D.C. Cir. 1989), *cert. denied*, 110 S. Ct. 717 (1990).

150 Cable Act, § 622(b), 47 U.S.C. § 542(b) (Supp. V 1987).

151 Cable Act, § 611(b), (e), 47 U.S.C. § 531(b), (e).

152 Communications Act of 1934, § 315, 47 U.S.C. § 315 (1982 & Supp. V 1987).

employment standards to meet.[153] Furthermore, while the broadcasters opposed Senator Inouye's bill introduced in the current Congress limiting advertising during children's programming,[154] cable operators endorsed it.

A must-carry rule premised on the theory of broadcasters as public trustees is therefore unsustainable. Broadcasters have been relieved of past responsibilities and cannot have the benefits attendant with regulatory relief if they are not required to participate in the market. Cable operators must construct their own "spectrum." More specifically, they must spend far more than broadcasters to put in place their physical delivery system and then must pay municipalities millions of dollars in franchise fees for the privilege of activating it under the theory that they are using public rights of way. Broadcasters, on the other hand, need not pay for the physical spectrum owned by the government that they use.

4. Spectrum Fee Proposals

Henry Geller, former FCC General Counsel and Administrator of NTIA, suggests that Congress "eliminate the underlying public trustee scheme of broadcasting, and replace it with a system where broadcasters are required to pay for the spectrum they use."[155] The Commission has already addressed the issue of injecting market mechanisms to replace regulatory safeguards. The "Auction Licensing Act of 1987"[156] was proposed as a means for licensing paging, specialized mobile radio, and domestic satellite services.[157] In 1987, the Commission made a similar proposal to authorize the Commission to use auctions under certain circumstances.[158]

In 1989, cable franchise fees exceeded $600 million.[159] If television broadcasters were required to pay 5% franchise fees,

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[153] Cable Act, § 634, 47 U.S.C. § 554.

[154] S. 1992, 101st Cong., 1st Sess. (1989).

[155] Geller & Lampert, *supra* note 141, at 13. Mr. Geller suggests that the income from these spectrum use fees could go to public broadcasting stations. *Id.* at 14.

[156] Auction Licensing Act of 1987 (bill proposed Apr. 26, 1987) (letter from Dennis R. Patrick, Chairman, FCC, accompanying bill on file with the FCC).

[157] *Id.*

[158] *Id. See* Background Memorandum on Auction Licensing Act of 1987, F.C.C. at 4 (Apr. 26, 1987). House Energy and Commerce Committee Chairman John Dingell, a Michigan Democrat, stated in February, 1990 that during the current Congress " 'given . . . the dwindling obligations of broadcasters to serve the public, the committee will look at spectrum charges probably with more sympathy than in previous years.' " Halonen, *Spectrum Fees Get Renewed Push*, ELECTRONIC MEDIA, Feb. 5, 1990, at 31.

[159] *See Oversight of Cable TV*, *supra* note 131, at 66 (statement of James P. Mooney, President, NCTA).

they would have paid the federal government $1.3 billion. Exposing broadcasters to the realities of the marketplace would provide impetus for them to produce quality local programming. Must-carry/must-pay schemes would have an adverse effect on programming and be a disincentive to improvement.

B. *Leased Access*

The FCC asks whether any changes are needed in the Cable Act's scheme for leased channel access to cable systems by independent program suppliers.[160] Section 612(b)-(f) of the Cable Act requires cable systems to provide "leased access" channels to unaffiliated entities and to establish a mechanism by which parties denied such access can seek legal redress.[161] Since enactment of the Cable Act, leased access channels have been utilized by a variety of users on a number of cable systems. Use of leased access channels has not been universal, however, and this is attributable primarily to a lack of user demand. Where channels or time slots have been leased, it has usually been on larger systems. Since most leased channels rely on advertiser support, this may suggest that a critical mass of potential viewers is necessary to support certain leased access programming. The same may be said for most basic cable programming.

Leased access users have offered programming services that are both competitive with and complementary to basic services carried on cable systems. For example, on Continental Cablevision's Quincy, Massachusetts system, *The Patriot Ledger* places classified advertising on a channel which reaches five cities and towns in the newspaper's circulation area.[162] Some leased access programming is targeted at particular audiences. For example, since 1987 Continental's Southfield, Michigan system has leased two hours each night to TV Orient which produces news, variety, and talk shows for people from the Middle East.[163]

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[160] Notice of Inquiry, *supra* note 1, at 369.
[161] Cable Act § 612, 47 U.S.C. § 532 (Supp. V 1987).
[162] From 1985 through 1988, Quincy and other Continental systems in the Greater Boston area also carried "Around Town," a 24-hour-a-day advertiser supported consumer information service concentrating on entertainment and recreation. In Springfield, Massachusetts, commercial users have leased channel capacity to promote real estate as well as other commodities and services. In Broward County, Florida, some 30 different users have taken advantage of leased access opportunities. The leased access users have ranged from health care providers to retailers to local religious organizations. In Jacksonville, Florida, an equally diverse group of leased access users has included realtors, sports promoters, and self-improvement firms.
[163] Several other cable operators in Southeast Michigan lease channel time to TV Orient. In Los Angeles, leased access programming is also targeted to specific ethnic groups including Armenian, Arab, Iranian, and Russian audiences. In Richmond, Vir-

Thus, leased access provides the opportunity for commercial users to access cable consumers for many programming purposes. The fact that utilization of leased access channels may not be widespread is due chiefly to the fact that more users have not availed themselves of this opportunity. Those who charge cable operators with being a "bottleneck" should be required to demonstrate that they have sought and been denied access to cable systems under section 612(b)-(f).[164] Upon examination, the FCC will find that the leased access provisions of the Cable Act have not been used by those who allege difficulty in obtaining access to cable systems.

V. Regulatory Options

A. *Rate Regulation*

The FCC in the section of the Notice of Inquiry that addresses proposed rate reregulation has asked a number of specific questions about proposals for changes in the standards and procedures for franchising authority rate regulation.[165] These questions are in many cases identical to the questions asked in the Commission's Notice of Proposed Rulemaking on reexamination of the effective competition standard.[166] This Article noted earlier that rate deregulation has improved the programming, plant, customer service, training, and community service efforts of cable operators throughout the country.[167] Consumers should not be returned to the pre-Cable Act situation where city councils could force cable operators to set basic rates at uneconomic levels, particularly in light of the increase in competition to cable from competitors unhindered by rate regulation and other requirements.

Programming and technological development have flourished since rate deregulation. To turn the regulatory clock back to 1984 would slow these efforts and deny the cable industry the ability to realize its full potential as a video and information provider.

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ginia leased access programming competes with cable company-produced local origination. Since 1987, Continental's Richmond system has leased 15 hours per week to a user who provides a locally originated talk show featuring programming on a variety of business, community, cultural, and health issues.

[164] Cable Act § 612(b)-(f), 47 U.S.C. § 532(b)-(f) (Supp. V 1987).

[165] Notice of Inquiry, *supra* note 1, at 369-70.

[166] Reexamination of the Effective Competition Standard for the Regulation of Cable Television Basic Service Rates, MM Docket No. 90-4 (Jan. 22, 1990), *reprinted in* 55 Fed. Reg. 4208 (Feb. 7, 1990).

[167] *See supra* notes 19-24 and accompanying text.

B. *Trafficking Restraints*

The GAO and the FCC are jointly studying whether there is in fact any effect on rates from, as the Commission states in the Notice of Inquiry, "rapid sale and resale of cable systems."[168] Cable multiple system operators ("MSOs") with a long-term commitment to the cable industry have no objection to the federal government imposing reasonable anti-trafficking limits. For example, Continental Cablevision built its first cable system in 1964 and has made long-term investments in the communities it serves, as is evidenced by the fact that it has never sold a system that it has operated.

An anti-trafficking limitation such as that previously imposed on broadcasters—a three year holding period—would discourage those "asset players" who might attempt to enter the industry solely to buy up cable systems, increase subscriber rates, and flip the properties for quick profits. One hardly adds value if property is held for a short time. A reasonable anti-trafficking rule would also be likely to discourage overbuilders who were seeking only to extract greenmail from established operators. Once having obtained a franchise to build an overbuild system, cable operators could not sell out for a period of years. Responsible cable companies would not be hurt by anti-trafficking rules, only potential speculators.

Any anti-trafficking rules imposed on the cable industry should, however, be imposed on broadcasters at the same time as cable operators. Many in Congress have noted that the repeal of the anti-trafficking rule by the Commission in 1982[169] has led to a decrease in the "public trustee" rationale for special treatment for broadcasters. It is difficult to be a public trustee of a government-granted frequency, substantially contributing to the community you are licensed to serve, if you hold that frequency only for a short time. Furthermore, as noted previously, there is no actual difference between broadcasters raising advertising rates for so-called "free television" and cable operators directly "raising rates" to compensate for paying a high station price.[170] Broadcasters simply raise advertising rates to pay for higher debt service, which has a direct effect on the consumers's cost of products and services.

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168 Notice of Inquiry, *supra* note 1, at 370.

169 Amendment of Section 73.3597 of the Commission's Rules, 52 Rad. Reg. 2d (P & F) 1081 (1982), *modified*, 99 F.C.C.2d 971 (1985).

170 *See supra* notes 26-28 and accompanying text (discussing true costs of "free television" as opposed to cable television).

VI. National Concentration, Vertical Integration, and Market Power

A. *Horizontal Concentration*

1. National Limits

The FCC has previously found that cable is not a concentrated industry relative to other American businesses. In 1982, the FCC terminated a rulemaking on whether to limit the number of cable systems or the number of cable subscribers that could be controlled by any single cable MSO.[171] The FCC cited its own 1981 Office of Plans and Policy study, which concluded that cable industry concentration at that point was "neither high . . . nor likely to become so in the forseeable future."[172] The Commission also noted that "it is probably inappropriate to consider cable entirely separate from the broader video entertainment markets in which cable participates."[173]

The FCC has, however, found broadcast television to be a potentially concentrated industry and has traditionally placed limits on the number of broadcast stations that any single entity can own.[174] Thus, the FCC must decide whether today's circumstances are so different from those in 1982 that the Commission should reconsider whether horizontal concentration limits similar to those it imposes on broadcasters would be beneficial to the cable industry and the public. The original Danforth bill, for example, would have limited a single MSO to 15% of the nation's cable subscribers.[175]

No one cable company admittedly should be allowed to possess inordinate power to deliver subscribers to their own program services or another entity's program services. It may also be that a company's national size can be an impediment to providing quality customer service. The larger the company, the more difficult it may be for the company to communicate with all

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[171] CATV Ownership, Multiple Report, 91 F.C.C.2d 46 (1982).

[172] *Id.* at 49. The OPP study concluded that "it seems likely that MSO growth (short of growth to a very high market share) is based on organizational efficencies and hence is desirable." *Id.* The study continued, noting that "[i]f the situation were to change drastically in the future, the antitrust laws could be used to insure that MSO concentration does not adversly affect performance in the franchising and programming markets." *Id. See, e.g.,* Gordon, Levy & Preece, *FCC Office of Plans and Policy*, 106 (Staff Report, FCC Policy on Cable Ownership (Nov. 1981)).

[173] *CATV Ownership*, 91 F.C.C.2d at 49.

[174] The Commission amended its multiple ownership rules in 1984 to limit ownership by a single entity to television stations serving no more than 25% of the nation's audience. Multiple Ownership of AM, FM, and Television Broadcast Stations, 50 Fed. Reg. 4666 (1985).

[175] S. 1880, 101st Cong., 1st Sess. § 10(f)(1) (1989).

systems and to impress on all local managers and employees the company's ethic of customer service. Whether that limit has yet been reached by any MSO is a decision that Congress should determine based on data collected in this inquiry and provided to it by the FCC.[176]

2. State Limits

Congress has appropriately focused on national subscriber limits rather than state by state limits. Most cable programming services are oriented toward national audiences. Although some are oriented toward regional audiences, few are oriented to audiences by state. There are many other considerations that argue against imposition of horizontal concentration limits on a state or regional basis. Indeed, the benefits that have resulted from the regional clustering of cable systems far outweigh any conceivable dangers.

By clustering cable systems, operators have been able to achieve economies of scale in providing cable services. For instance, regional systems can be staffed from early morning until late at night whereas smaller systems cannot.[177] In the area of local programming, cable companies can produce high quality local news and public affairs programs when they have a regional subscriber base of sufficent size to support state-of-the-art television production facilities. The ability to cluster systems regionally also enables cable companies to use broadcast and other media to promote cable services. It allows cable operators to promote pay-per-view events economically as well. Clustering also allows cable operators to compete with other media for local advertising dollars, which will ultimately reduce pressure on cable subscription fees. In most systems, local advertising presently contributes less than one dollar per month per subscriber.

Thus, by concentrating cable system ownership in particular

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[176] It appears that the company that would be most affected by a horizontal cap, Tele-Communications, Inc. ("TCI"), the nation's largest MSO, is prepared to divest itself of part of its subscriber base if Congress sets national subscriber limits. Last November, TCI President John Malone testified before Congress that he would not oppose a reasonable cap limiting the number of subscribers TCI could serve. *Reregulatory Pendulum Swings Toward Cable*, BROADCASTING, Nov. 20, 1989, at 27. James Robbins, President of Cox Cable Communications, the fifth largest cable MSO, also stated his lack of objection to horizontal limits at the same hearing. *Id.* More recently, TCI announced its intention to spin off certain programming and system assets into a separate company. Fabrikant, *Tele-Communications Plans Cable Programming Spinoff*, N.Y. Times, Jan. 20, 1990, at 33, col. 1.

[177] They can also have emergency crews available 24 hours per day, 7 days per week. With larger subscriber bases and numbers of employees, regional systems can also afford to establish well-equipped modern training facilities.

geographic areas, MSOs can achieve economies that benefit consumers and cable operators alike. To set artificial limits on system ownership by state or geographic region would only result in the swapping of cable systems by MSOs and would create a crazy quilt or uneconomical pattern of cable system ownership. While there may be reasons to limit the power any one cable operator can wield nationally to protect new programming entrants, the same considerations do not exist at the state or local level.

B. *MSO Concentration: Effects on Programming Services*

The FCC shows concern in its Notice of Inquiry about the number of cable subscribers that must be "cleared" nationally to begin a new program service.[178] It asks whether it is necessary for a new program service to grant equity positions to cable MSOs in order to enter the market.[179] Federal and local regulators of the cable industry have consistently called on cable operators to provide unique, diverse, educational, cultural, interest-specific, high quality programming.[180] Such high demands are risky to undertake. Broadcast network affiliates, with rare exceptions, did not during the past few decades venture far from the half-hour to one hour sit-com and bite-sized news capsules fed to them from the national networks. Independent broadcasters also, until recently, were satisfied to repeat movies and staple comedy and dramatic formats.

Cable programmers, therefore, were understandably hesitant to undertake the considerable risk that consumers would reject this new programming. Equity participation by cable operators was a mechanism to share this risk. To launch untested programming stigmatized as "educational" or "cultural" or "minority oriented" in a market accustomed to programming geared for mass consumption translates into high capital investment and extraordinary risk.

Instead of being satisfied with serving merely as an antenna service for broadcast stations, cable operators were willing to finance the development of programs because they could guarantee carriage for the length of time necessary for consumers to

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178 Notice of Inquiry, *supra* note 1, at 371.

179 *Id.*

180 As far back as 1968, the FCC stated: "[T]he CATV operator has greater . . . flexibility . . . to present programing [sic] of minority interest on some channels." Notice of Proposed Rulemaking, CATV, 15 F.C.C.2d 417, 421 (1968). The FCC ultimately adopted rules requiring cable-originated programming.

appreciate the value of this alternative.[181] Having now met the challenge of providing new and innovative programming, cable should not be punished for its willingness to put its money where regulators have for years been telling them they should put it.

Equity participation also generates efficiencies that enable cable operators to provide new programming services. Cable operator investors in programming can use their general marketing and advertising to promote specific programming while independent programmers must undertake their own campaigns. Research and development of programming concepts without a real world audience for testing purposes can be eliminated. Cable operators survey their customers' interests and needs, and thus are in a better position to make the investments necessary for a new service. With cable operators having shown the way, other independent venturers, without cable operator participation, have also entered the cable industry successfully. In fact, there are a substantial number of successful cable program networks without MSO ownership.[182] Therefore, equity participation by cable operators has not become a barrier to entry into the cable programming marketplace.

C. *Competition for Programming Between the Cable Industry and Other Delivery Media*

1. Cable's Brand-Name Exclusivity

Cable programmers should be able to sell exclusivity to cable systems rather than other media. Exclusive distributor relationships are common in the American marketplace. Ford dealers do not sell GM cars and every appliance dealer does not sell Whirlpool and Maytag washers. Further, one does not see NBC programming on CBS, nor for that matter offered to cable operators as network affiliates. The commercial broadcast network-affiliate relationships are, in fact, the essence of exclusivity. Exclusivity is historically common and legally sanctioned in

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[181] Such programs include Discovery, Nickelodeon, C-SPAN I and II, Black Entertainment Television, Bravo and Lifetime, as well as MTV, VH-1, HBO and Showtime. Without cable operator investment, it is also unlikely that Turner Broadcasting could have continued to be the vital force for innovation in news, public affairs, and original entertainment that it is today.

[182] These include ESPN (majority-owned by a broadcast network, CapCities/ABC), USA Network (owned by two studios, MCA and Paramount), the Disney Channel (owned by another studio), Arts & Entertainment, The Nashville Network, the Weather Channel, Financial News Network, and Home Shopping Network.

broadcasting.[183] Why, then, is there any concern when cable operators seek the same rights?

Jurists and economists have rather consistently viewed exclusive agreements as pro-competitive because they stimulate interbrand competition among manufacturers of the same generic product and generate efficiencies in the market.[184] The product in exclusive agreements between programmers and cable operators is video programming, *e.g.*, a brand-name channel such as HBO, Showtime, or CNN. Exclusive agreements between manufacturers and distributors, whether for automobiles, appliances, or video programming, promote competition and bring efficiencies to the market at every level of production and consumption. From the standpoint of the producer of programming, an exclusive outlet for a program insures that a distributor will take an aggressive marketing approach. Suppliers want assurance of quality distribution and service and aggressive local promotion. Conversely, distributors want to know that their promotional efforts are going to accrue to their own benefit.[185]

In the absence of an exclusive rights contract, program distributors have less incentive to market programming. This is the problem of the "free rider."[186] Distributors will not take the initiative or undertake the expense of marketing a program that is available through its competitors. Programmers need affiliates who will conduct aggressive promotional campaigns to differentiate their product and expand their distribution base. This promotion is essential to a cable network. Each one wants the public to sort out its brand name from among all the other channels. To do so, they must be given product identification by their distributor. Cable operators who do this deliver a valuable service to the program packager and therefore should be their designated distributor.

Exclusive rights agreements are particularly beneficial to newcomers in the market. Broadcasting is again instructive as an

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[183] *See* Ralph C. Wilson Indus., Inc. v. Chronicle Broadcasting Co., 794 F.2d 1359 (9th Cir. 1986).

[184] *See* Continental T.V., Inc. v. GTE Sylvania, 433 U.S. 36, 52-53 (1977). Continental T.V., Inc. is not affiliated with Continental Cablevision, Inc.

[185] Through marketing and promotion, for example, cable operators have created brand name identification for HBO. Indeed, many cable subscribers equate cable television with HBO. Cable operators spend millions of dollars on advertising and direct mail marketing to promote HBO's products each year. Having made this substantial investment of time and money in promoting HBO and developing its brand name identification, it is unreasonable for cable operators to be the exclusive distributor of these products in the markets they serve.

[186] *See* POSNER, ANTITRUST LAW: AN ECONOMIC PERSPECTIVE 149 (1976).

example. Some years ago, the market for broadcast television was fairly evenly divided between the three networks. While there was hope that the increased availability of independents—in large measure because of the increased audience reach provided by cable distribution—might inject some degree of competition into the broadcast market, there was no expectation that a new network could enter the market. Exclusivity, however, made it happen. The benefit of this arrangement for program suppliers is evident. Programs which were either non-existent or on other media outlets are now main attractions for Fox Television.[187] Fox should not now be required to allow a cable network such as USA or TNT to obtain the same programs it developed or produced. Nor should NBC or CBS be required to allow cable operators to become affiliates under the same terms as broadcasters.

The benefits of exclusive rights agreements have been recounted by experts in the antitrust field.[188] The FCC also has extolled the virtues of exclusivity, most recently in reimposing syndicated exclusivity rules on the cable industry.[189] Noting that "the ability to enter into exclusive contracts is a widely used competitive tool that is important to program suppliers, cable operators, and broadcasters,"[190] the Commission concluded:

> By granting an exhibitor the exclusive right to show a particular program in its market, the program supplier maximizes the incentives of the exhibitor to promote the program and its ability to compete with other exhibitors. Any additional audience generated by the promotional efforts of an exhibitor translates into larger revenues for the exhibitor and larger payments to the program supplier.[191]

The FCC also allowed broadcasters to obtain territorial exclusivity and is proposing to expand that ability.[192]

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187 Fox Television succeeded in negotiating exclusive rights agreements with producers of such programs as "It's Gary Shandling's Show" (formerly on cable), "Married With Children," "21 Jump Street" and "The Tracy Ullman Show." Fox would not have promoted these shows if they were also available on ABC, NBC, and CBS. Fox would also not have achieved its success in the marketplace if these programs were available on other channels.

188 "Analysis shows that every vertical restraint should be completely lawful." R. BORK, THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF 288 (1978).

189 Program Exclusivity in the Cable and Broadcast Industries, 3 F.C.C. Rcd. 5299 (1988).

190 *Id.* at 5309.

191 *Id.* (footnote omitted).

192 Further Notice of Proposed Rule Making, Gen. Docket No. 87-24, 3 F.C.C. Rcd. 6171 (1988).

In its seminal 1988 study on video distribution and cable television, NTIA addressed this issue and noted that

> [b]oth buyer and seller can benefit from the availability and enforceability of exclusive rights. For the buyer, exclusivity may differentiate the programming, making it more marketable. For the seller, by using exclusivity as a concept to divide the range of possible licensees into different markets, the seller can arrange a sequence of distribution that will maximize revenue from the licensing of that product through several uses.[193]

Were the FCC to urge Congress to mandate that programming developed by the cable industry be made available to all other distribution technologies, it would be an incredibly unjust reward for the diversity cable has brought to consumers and serve as a strong disincentive to the development of new programming channels.

2. Program Availability to Home Satellite Dish Industry

The Commission's questioning in its Notice of Inquiry of the availability of programming for the Home Statellite Dish ("HSD") industry,[194] on the heels of the 1988 release of the Commission's own two year-long "Inquiry into the Scrambling of Satellite Television Signals and Access to those Signals by Owners of Home Satellite Dish Antennas,"[195] brings to mind the persistence of the Flat Earth Society. Although there remain skeptics, whether one examines studies already compiled by NTIA, industry commentators, or the FCC itself, the studies show conclusively that HSD households have access to a wide variety of programming from a variety of sources at prices comparable to or below those paid by cable subscribers.[196]

When the Commission first investigated possible discrimination against the HSD industry by cable operators, it concluded that a rational person would not make the irrational business decision to discriminate.[197] These business realities will not

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193 NTIA Report, *supra* note 92, at 109-10 (footnotes omitted).

194 Notice of Inquiry, *supra* note 1, at 372.

195 The investigation was agreed to on June 12, 1986, during a hearing before the Subcommittee on Telecommunications, Consumer Protection and Finance of the House Energy and Commerce Committee. Inquiry into the Scrambling and Access to Those Signals by Owners of Home Satellite Dish Antennas, 3 F.C.C. Rcd. 1202, 1211 n.2 (Mar. 11, 1988) [hereinafter *HSD Inquiry II*].

196 *Id.* at 1203.

197 Inquiry into the Scrambling and Access to Those Signals by Owners of Home Satellite Dish Antennas, 2 F.C.C. Rcd. 1669, 1683 (Mar. 23, 1987). The Commission stated:

> The incentives of cable systems and MSOs to serve HSD households appear consistent with the programmers' reliance on them as major distributors.

change. By increasing the availability of programming already produced, cable operators can serve incremental customers at no added cost to the operator.

A year later, and after a series of quarterly "Progress Reports" on the status of developments in the HSD market, the Commission issued its "Second Report" which, at the time, was to complete its current program of monitoring the HSD industry.[198] In this report the Commission acknowledged that the cable operators and programmers, and in some cases operator/programmers, have taken every opportunity to make their programming available to the HSD owners.[199]

Conversely, the broadcast networks all planned to scramble their network feeds and did not intend to market them to HSD households. The Commission concluded that the broadcast network satellite feeds of "The Cosby Show," "Cheers," and "L.A. Law," for example, "were not broadcasting but private communications [and, therefore,] the prohibition of unauthorized reception . . . applies to them, and the networks are legally entitled to scramble their feeds and to refrain from providing them to HSD households."[200] Not surprisingly, the Commission also relied on the exclusivity provisions "that are a foundation of the network-affiliate distribution system that well serves the overwhelming majority of television households."[201] Since the FCC's Second Report was issued in 1988, the Department of Justice has also closed its investigation of cable's influence on the market for home satellite distribution as well as MDS, and brought no civil or criminal charges.[202]

In 1989, the Commission reported on yet another inquiry, the existence of discrimination in the satellite provision of independent broadcast superstation and network station program-

> Cable systems, like other retailers, are spurred to expand the volume of sales by the prospect of additional revenue and additional profit. Moreover, the skills, personnel, and equipment needed to sell to and service HSD accounts are identical to those needed for cable accounts.

Id.

198 The Second Report states that "HSD households have access to virtually every satellite-delivered program service, but important questions remain unresolved with respect to the provision of television broadcast programming to those households. With minor exceptions, every scrambled satellite cable channel (*e.g.*, HBO, CNN, ESPN, *etc.*) is being marketed to HSDs." *HSD Inquiry II*, *supra* note 195, at 1209.

199 *Id.* at 1209-10.

200 *Id.* at 1210.

201 *Id.*

202 *Justice Closes Cable Investigation*, Satellite Times, May 4, 1988, at 1.

ming.[203] The Commission found that there appeared to be "no general pattern of unlawful discrimination by satellite carriers among the various entities operating as distributors of superstation and network station programming."[204] However, the Commission did express concern that some satellite carriers were charging higher rates for programming provided to home dish distributors than rates charged for cable distribution.[205] The Commission stated that it would initiate a new study to determine whether there is any weight to these new allegations.

But the facts have not changed. The world is round and programming is available on a nondiscriminatory basis. Satellite carriers may be charging different rates to different customers. Market efficiencies often result in price differentials. Cable operators, in general, reach many more subscribers in a concentrated geographic area. Furthermore, cable operators may have histories of timely payment, ease of service, and high end equipment, all of which are elements of price. The satellite dish market is dynamic, and market forces have successfully kept a check on anticompetitive behavior.

3. MSO Size and Volume Programming Discounts

Although the size of a large MSO may enable it to obtain programming on more favorable terms than a smaller company, size is by no means the sole determinant in license fee negotiations. There are a variety of considerations that cable program networks seek and often obtain from individual system operators or MSOs that are not related to volume but justify license fee discounts. For example, some cable networks, and particularly subscription services such as HBO, Showtime, and The Disney Channel, seek preferential positioning to consumers and preferred marketing status and are willing to reward cable systems who feature their programs prominently or do a particularly good job of promoting the network's brand.

An operator who achieves a high subscription penetration of homes passed or basic subscribers, or who prices the product favorably will usually receive a more favorable rate than one who does not, notwithstanding the latter's larger number of subscrib-

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[203] Inquiry into the Existence of Discrimination in the Provision of Superstation and Network Station Programming, F.C.C. 89-365 (Dec. 29, 1989).

[204] *Id.* at 5-6.

[205] *Id.* at 6.

ers.[206] By prominently featuring a programming service in its marketing materials and strategies, *i.e.* telemarketing, an operator can often obtain a more favorable rate. Operators who are willing to offer an advertiser-supported service special and regular promotion or preferred channel line-up position may be entitled to special rate discounts. Operators can also frequently obtain more favorable rates by agreeing to a longer term contract, by offering to carry a service on all of its systems, or by agreeing to a "roll out" or launch of a new service rapidly to its subscriber base.[207]

Since rates vary from one MSO system to another, depending on the system's local characteristics, it would be extremely difficult to generalize about the direct impact of reduced license fees to MSOs on consumers. A large MSO's programming cost savings may instead be reflected in improved customer service, superior system maintenance or greater local programming investment. Consumers can benefit from the uses to which savings are applied, not only from rate reductions.

D. *Vertical Integration*

Vertical integration increases consumer welfare. Whether benefits are measured in economic terms, in the availability of products, or in consumer satisfaction, market analysis proves that efficiencies occur when programming distributors invest in programming production. Vertical integration is common in the broadcast industry, most notably in the broadcast networks. Each of the networks has a number of owned and operated stations, whose allowable national reach was expanded in the early 1980s by the Commission. The dynamics of vertical integration are especially efficient in the cable industry. The history of cable's success in increasing the supply of diverse video programming is, in fact, a case for vertical integration.[208]

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206 Indeed, a single system, by virtue of its high penetration level of a premium service, could have a more favorable rate than a large MSO.

207 License fee discounts or reductions are offered by programmers for other reasons as well, including the value of cable carriage in a key DMA, willingness to give up tiering flexibility, and carriage of complementary services.

208 Cable's uniqueness as a medium lies in the specialized programming services that the cable industry has nurtured and supported over the past 15 years. C-SPAN was created as a public affairs service by the cable industry. Nickelodeon and the Disney Channel have filled a void in children's programming created by network abandonment which only public television previously had attempted to fill. Likewise, Black Entertainment Television, several Hispanic networks, Bravo, and Arts & Entertainment have been created in response to minority tastes and needs. Twenty-four hour news, unedited congressional proceedings, music videos, and home shopping are whole categories of programming that now exist only because cable created them.

The success of any enterprise requires capital, risk, and expertise. Vertical integration is an economic tool that puts these three elements into the proper perspective so that an investment in the enterprise will generate a successful product. This is particularly true when there is significant interdependency between the integrated product markets. Video programmers without a medium or cable operators without programming are losing propositions. Vertical integration works to ensure capital, diminish risk, and take advantage of expertise creating an environment where cable operators will provide reliable service and programmers will produce quality programming.[209]

As noted earlier, equity participation by cable MSOs is not the only means for a cable programming network to be successful in the marketplace.[210] While several major companies such as Time-Warner and Viacom are both program producers and cable system operators, the vast majority of cable operators are not programmers. In fact, most cable operators do not have any significant ownership interest in most of the programming services they carry.

When Turner Broadcasting experienced financial difficulties, however, cable operators responded in order to keep Cable News Network alive and independent.[211] Cable operators have responded in such ways not with the principal aim of becoming programmers, but to maintain cable's competitiveness in a dynamic video marketplace. From the operator's point of view, the better a particular service is, the better all of cable looks as a mix. Cable operators want innovative services to survive. For new services, like Turner Network Television, operator investments may be the only way to get early commitments to carry the new network at all.

Operator investment in programming is therefore a natural

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209 These benefits have not gone unnoticed by the FCC, which has agreed that vertical integration is a positive force in the communications business:

> Vertical integration may produce economies in the firm's use of technical, managerial and marketing resources. It may minimize the firm's profit fluctuation through diversification and thus reduce the cost of capital to the integrated firm by reducing the risk to investors. The very process of negotiating and enforcing many contracts may be expensive and, for some products, self supply can reduce or eliminate these costs. Savings also might result from the greater ease of monitoring quality within the firm.

FCC Network Inquiry Special Staff, Final Report, New Television Networks: Entry, Jurisdiction, Ownership and Regulation 375-76 (1980).

210 *See supra* notes 178-82 and accompanying text.

211 When other cable programmers, including Discovery and C-SPAN, have encountered financial difficulties, cable operators voluntarily agreed to increases in programming fees they have paid.

outgrowth of these forces. But a responsible operator will not just carry those services in which it has a small investment interest. If a service is not bringing in customers and disconnects are high, the operator will not destroy its retail business to support a programming investment. Many businesses operate with a mix of their own labeled brands and independent brands.[212]

Other policymakers have undertaken extensive studies of the effects of vertical integration on competition in the market and have concluded that the benefits of a telecommunications policy which encourages vertical integration outweigh the potential drawbacks.[213] An NTIA study noted that while a cable service is somewhat more likely to be carried if it shares an ownership affiliation with the cable system making the carriage decision, "there is scant support for the notion that vertical integration into pay programming by MSOs has led them to discriminate against unaffiliated services, thereby reducing the diversity of pay services to their subscribers."[214]

NTIA also made several other observations. First, vertical integration does not give cable operators any greater power to establish excessive subscriber rates than competitive conditions in the franchise areas already permit.[215] Second, vertical integration has been part of cable since its inception and is not a new phenomenon.[216] Moreover, vertical integration can have many benefits, including substantial reductions in costs. Integration also stimulates new cable programming services, since without an assured operator base, starting a new service would be a highly

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212 Grocery stores, drug stores, and clothing stores all operate in this manner. Safeway, CVS, and Macy's could not make it just on generic brands, and almost always carry products that compete with their own brands. The same is true for cable.

213 NTIA, for example, made the following observations in its 1988 study:

> Common ownership of a cable system and a cable program service may produce significant benefits for the integrated firm and its customers. The principal benefit is that vertical integration allows the cable firm to avoid the transaction costs of obtaining programming. These costs include not only time, manpower and money expended in negotiating and enforcing program contracts, but also costs caused by the uncertainties of completing agreements in an adversarial setting . . . .
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> Vertical integration can eliminate or substantially reduce these transaction costs by bringing program contract negotiations within the confines of a single firm . . . .
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> Vertical integration can also expand the supply of cable programming, thus expanding the diversity of viewing choices for subscribers.

NTIA Report, *supra* note 92, at 90-91 (footnotes omitted).

214 *Id.* at 98.

215 *Id.* at 92.

216 *Id.* at 89 (citing as examples HBO/ATC and Showtime/Viacom).

risky undertaking.[217] Common ownership of cable systems and cable programming services does not appear to adversely affect the supply of cable programming or the diversity of viewing choices for cable subscribers.[218] Any rules restricting vertical integration would eliminate the benefits that flow from these arrangements, and would impose hardship on parties who have made substantial investments in programming services.[219] Finally, decisions by cable programmers concerning to whom or through whom to distribute their services are not influenced by the ownership of the programmer by a cable system operator.[220]

As noted previously, it would be inconsistent for the FCC to fault cable operators for acquiring interests in cable programming. Cable operators have been accused for years of being nothing but line installers and retail marketers and exhorted to fulfill the "promise" of cable by supporting and developing innovative programming concepts. Now that the industry is doing so, it should not be attacked for it.

VII. Conclusion

At the close of the FCC's Cable Notice of Inquiry, the Commission asks for suggested remedies to "best provide a competitive cable marketplace."[221] A heavy burden of proof should be placed on those arguing that the careful balance created by the Cable Act is sufficiently impaired that it needs to be fixed. Cable faces a highly competitive marketplace and any significant alterations in that marketplace could leave cable at a disadvantage as to present and future competitors. This could harm the ability of cable to continue to provide the "many new programming services valued by viewers" the Commission in its Notice of Inquiry approvingly cites.[222]

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217 *Id.* at 90-92.
218 *Id.* at 102.
219 *Id.* at 106.
220 *Id.* at 104-07.
221 Notice of Inquiry, *supra* note 1, at 375.
222 *Id.*