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FOR IMMEDIATE RELEASE  
December 31, 2002

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## **FCC RELEASES NINTH ANNUAL REPORT ON COMPETITION IN VIDEO MARKETS**

Washington, DC – The Federal Communications Commission (FCC) released its ninth annual report on competition in the market for the delivery of video programming. The report provides updated information on the status of competition in the market for the delivery of video programming, discusses changes that have occurred in the competitive environment over the last year, and describes barriers to competition that continue to exist.

The report finds that competitive alternatives and consumer choices continue to develop. Cable television still is the dominant technology for the delivery of video programming to consumers, although its market share continues to decline. As of June 2002, 76.5 percent of all subscribers to multichannel video program distributor (MVPD) services received their programming from a franchised cable operator, compared to 78 percent a year earlier.

Since last year's report, the total number of subscribers to both cable and non-cable MVPDs increased to 89.9 million households as of June 2002, up 1.8 percent over the 88.3 million households subscribing to MPVDs in June 2001. This subscriber growth accompanied a 1.2 percentage point decrease in MVPDs' penetration of TV households to 85.3 percent as of June 2002, indicating that TV households are increasing at a faster rate than MVPD subscriber growth.

The number of cable subscribers reached nearly 68.8 million as of June 2002, up about 0.4 percent from the 68.55 million cable subscribers in June 2001. Although industry data collected for this report period reflect continued growth through June 2002, a number of major cable system operators have experienced significant subscriber losses and calendar year 2002 may be the first year in which the cable industry as a whole experiences a net loss of subscribers.

The total number of non-cable MVPD subscribers grew to 21.1 million as of June 2002 from 19.3 million as of June 2001, an increase of more than nine percent. Direct broadcast satellite (DBS) service has grown significantly and now represents 20.3 percent of all MVPD subscribers. Between June 2001 and June 2002, the number of DBS subscribers grew from almost 16 million households to about 18 million households, which is significantly higher than the cable subscriber growth rate.

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During the period under review, cable rates continued to rise. According to the Bureau of Labor Statistics, between June 2001 and June 2002, cable prices rose 6.3 percent compared to a 1.1 percent increase in the Consumer Price Index (CPI), which measures general price changes. Concurrently with these rate increases, the number of video and non-video services offered increased, and programming costs increased.

The ninth annual report details the status of competitors in the market for the delivery of video programming including: cable systems, direct-to-home satellite service (DBS and home satellite dishes), wireless cable systems, private cable operators (a.k.a. SMATV), broadcast television, local exchange carrier (LEC) entry, open video systems, broadband service providers, Internet video, home video sales and rentals, and electric and gas utilities.

The report also examines market structure and competition by evaluating horizontal concentration in the MVPD marketplace; analyzing vertical integration between cable television systems and programming services; and discussing technical issues such as cable modems, navigation devices and emerging services.

A list of the key findings of the report is attached.

Action by the Commission, December 23, 2002, by Report (FCC 02-338). Chairman Powell, Commissioners Abernathy, Copps, Martin and Adelstein.

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MB Docket No. 02-145

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## **KEY FINDINGS OF THE FCC'S NINTH ANNUAL REPORT ON VIDEO COMPETITION**

### **Industry Growth:**

In the *2002 Report*, the FCC examines the status of competition in the market for the delivery of video programming, discusses changes that have occurred in the competitive environment over the last year, and describes barriers to competition that continue to exist. Overall, although competitive alternatives continue to develop, cable television still is the dominant technology for the delivery of video programming to consumers in the MVPD marketplace. As of June 2002, 76.5 percent of MVPD subscribers received their video programming from a franchised cable operator, compared to 78 percent a year earlier.

The total number of subscribers to both cable and non-cable MVPDs continues to increase. A total of 89.9 million households subscribe to multichannel video programming services as of June 2002, up 1.8 percent over the 88.3 million households subscribing to MVPDs in June 2001. This subscriber growth accompanied a 1.2 percentage point decrease in MVPDs' penetration of television households to 85.3 percent as of June 2002.

Since the *2001 Report*, the number of cable subscribers continued to grow, reaching almost 68.8 million as of June 2002, up about 0.4 percent from the 68.55 million cable subscribers in June 2001. The total number of non-cable MVPD subscribers grew from 19.3 million as of June 2001 to 21.1 million as of June 2002, an increase of more than nine percent. Although industry data reflect continued growth through June 2002, a number of major cable system operators have experienced significant subscriber losses during this period and calendar year 2002 may be the first year in which the industry as a whole has had a net loss of subscribers.

DBS subscribership has grown significantly and now represents 20.3 percent of all MVPD subscribers. Between June 2001 and June 2002, the number of DBS subscribers grew from almost 16 million households to about 18 million households, which is significantly higher than the cable subscriber growth rate. The continued growth of DBS is still, in part, attributable to the authority granted to DBS operators to distribute local broadcast television stations in their local markets by the Satellite Home Viewer Improvement Act of 1999 ("SHVIA"). DBS attracts former cable subscribers as well as consumers not previously subscribing to an MVPD.

Over the last year, the number of subscribers to, and market shares of, OVS and private cable have remained relatively stable, although their market share remains small. The number of subscribers to MMDS and large dish satellite service (HSD) continue to decline. The participation of incumbent local exchange carriers in the distribution of video programming also continues to decline.

### **Cable Rates:**

During the period under review, cable rates continued to rise. According to the Bureau of Labor Statistics, between June 2001 and June 2002, cable prices rose 6.3 percent compared to a 1.1 percent increase in the Consumer Price Index ("CPI"), which measures general price changes. Concurrently with these rate increases, the number of video and non-video services offered increased, and programming costs increased. The report notes that cable operators' pricing decisions may be affected by direct competition. Available evidence indicates that when an incumbent cable operator faces "effective competition," as defined by the Communications Act, it responds in a variety of ways, including lowering prices or adding channels without changing the monthly rate, as well as improving customer service and adding new services such as interactive programming. A recent study from the General Accounting Office (GAO) found that while the provision of local broadcast channels by DBS companies is not associated with lower cable prices, the provision of local broadcast channels by DBS companies is associated with non-price competition. In areas where DBS operators provide local channels, the GAO results indicate that cable companies offer subscribers

approximately six percent more channels. According to GAO, this result indicates that cable companies are responding to DBS provision of local channels by improving their quality as reflected by the greater number of channels.

### **Convergence of Cable and Telephone Service:**

The Telecommunications Act of 1996 (“1996 Act”) removed barriers to telephone company or local exchange carrier (“LEC”) entry into the video marketplace to facilitate competition between incumbent cable operators and telephone companies. At the time of the 1996 Act, it was expected that LECs would compete in the video delivery market and that cable operators would provide local telephone exchange service. The FCC previously reported that the four largest incumbent local exchange carriers (“ILECs”) have largely exited the video business. This remains true today. A few smaller LECs continue to offer, or are preparing to offer, MVPD service over existing telephone lines. Alternatively, several cable multiple system operators (“MSOs”) continue to offer telephone service. Cable operators are beginning to deploy Internet Protocol (“IP”) telephony in addition to circuit-switched telephony offerings. Cable operators such as Cox and AT&T, continue to deploy circuit-switched cable telephony. Others, like Cablevision and Comcast, continue to offer cable telephony where it has already been deployed, but generally are waiting for IP technology to become widely available before accelerating their rollout of telephone service. AT&T, AOL Time Warner, Comcast, Cox, and Charter are currently offering or continuing to test IP telephony products.

### **High-Speed Internet Service:**

The most significant convergence of service offerings continues to be the pairing of Internet service with other service offerings. Cable operators continue to build-out the broadband infrastructure that permits them to offer high-speed Internet access. The most popular way to access the Internet over cable is still through the use of a cable modem and personal computer, though a small number of users continue to access the Internet through their television and a specially designed set-top box, rather than a personal computer. Virtually all of the major MSOs offer Internet access via cable modems in portions of their service areas. Like cable, the DBS industry is developing ways to bring advanced services to their customers. Many MMDS and private cable operators also offer Internet access services. In addition, broadband service providers continue to build advanced systems specifically to offer a bundle of services, including video, voice, and high-speed Internet access.

### **Promotion of Entry and Competition:**

Non-cable MVPDs continue to report that regulatory and other barriers to entry limit their ability to compete with incumbent cable operators. Non-cable MVPDs continue to experience some difficulties in obtaining programming from vertically integrated cable programmers and from unaffiliated programmers that continue to make exclusive agreements with cable operators. In multiple dwelling units (“MDUs,”) potential entry may be discouraged or limited because an incumbent video programming distributor has a long-term and/or exclusive contract. In addition, non-cable MVPDs report problems obtaining franchises from local governments and difficulties in gaining access to utility poles needed to build out their systems.

### **Distribution Technologies Findings:**

FCC findings as to particular distribution technologies operating in the market for the delivery of video programming include the following:

- **Cable Systems:** Since the *2001 Report*, there has been only marginal cable television industry growth in terms of subscribership (a 0.4% increase from June 2001), with a number of individual operators facing actual subscriber declines. Through June 2002, the industry has continued to grow in terms of revenues

(an approximate 15.9% increase between 2000 and 2001) and expenditures on programming. Audience share statistics for total day viewing show that cable audience shares rose from an average 54.2 share between July 2000 and June 2001, to an average 58.3 share between July 2001 and June 2002. Audience share statistics for primetime show that cable audience shares rose from an average 51.9 share between July 2000 and June 2001, to an average 56.5 share between July 2001 and June 2002. The number of national satellite-delivered video programming services increased from 287 to 308 between June 2001 and June 2002.

- The cable industry has continued to invest in improved facilities. As a result, there have been increases in channel capacity, the deployment of digital transmissions, and non-video services such as Internet access and telephony.
- **Direct-to-Home (“DTH”) Satellite Service (DBS and HSD):** Video service is available from high power DBS satellites that transmit signals to small DBS dish antennas installed at subscribers’ premises (DBS service), and from low power satellites requiring larger antennas (HSD service). DBS has more than 18 million subscribers, an increase of approximately 14 percent since the *2001 Report*. Between June 2001 and June 2002, the number of HSD subscribers, measured as the number of HSD users that actually purchase programming packages, declined from one million to 700,000, a decrease of about 30 percent. DirecTV and EchoStar are each among the five largest providers of multichannel video programming service. In June 2002, DBS represented a 20.3 percent share of the national MVPD market and HSD represented another 0.8 percent of that market.
- **Wireless Cable Systems:** Currently, the wireless cable industry (“MMDS”) provides competition to the cable industry in limited areas. MMDS subscribership declined between June 2001 and June 2002 from approximately 700,000 subscribers to 490,000 subscribers. With the advent of digital MMDS and the FCC’s authorization of two-way MMDS service, it appears that most MMDS spectrum eventually will be used to provide high-speed data services. Wireless cable represented an approximately 0.6 percent share of the national MVPD market in June 2002.
- **Private Cable Operators:** Private cable operators, also known as SMATV, use some of the same technology as cable systems, but do not use public rights-of-way, and focus principally on serving subscribers living in MDUs. Private cable subscribership increased slightly from 1.5 million subscribers last year to 1.6 million subscribers as of June 2002, representing approximately 1.8 percent of national MVPD subscribership.
- **Broadcast Television:** Broadcast stations and networks, and non-broadcast networks alike, must either produce programming or purchase programming from third-party producers. Broadcast networks and stations also are suppliers of content for distribution by MVPDs. In addition, they supply video programming directly to those television households that are not MVPD subscribers and to television sets in MVPD households that are not connected to such service. Since the *2001 Report*, the broadcast industry has continued to grow in the number of operating stations (from 1,678 in 2001 to 1,712 in 2002). Broadcast stations and networks, like MVPDs and non-broadcast networks, derive revenue from advertising. Advertising revenues and audience levels, however, declined for broadcasters in 2001, though low advertising figures are partly attributable to the generally slow economy in 2001. In 2001, advertising revenues were approximately \$36 billion, a 12 percent decrease since 2000 when advertising revenues were \$41 billion. Audience levels continue to decline as they have for many years. For total day (24-hour) viewing, broadcast television stations accounted for a combined 52.4 share of viewing in all TV households, down from a 56.2 share the previous season. During the 2001-2002 television season, broadcast television stations accounted for a combined average 59 share of primetime viewing among all television households, down from an average 63 share the previous season. Broadcast television stations continue to deploy digital television (“DTV”) service. Ninety percent of the more

than 1,300 commercial television stations have been granted a DTV construction permit or license and 643 are on the air with DTV operation.

- **LEC Entry:** The 1996 Act expanded opportunities for LECs to enter the market for the delivery of video programming. In the *2001 Report*, the FCC noted that ILECs have largely exited the video business. BellSouth, however, continues to operate some overbuild cable systems, and a number of smaller LECs that are offering, or preparing to offer, video service over telephone lines. Qwest Communications International (formerly US West) continues to offer video, high-speed Internet access, and telephone service over existing copper telephone lines using very high-speed digital subscriber line (“VDSL”) in several markets. Reports indicate that 45 LECs, mostly small, also are using VDSL to offer a bundle of services, including video, over telephone lines.
- **Open Video Systems:** In the 1996 Act, Congress established a new framework for the delivery of video programming -- the open video system (“OVS”). Under these rules, a LEC or other entrant may provide video programming to subscribers, although the OVS operator must provide non-discriminatory access to unaffiliated programmers on a portion of its channel capacity.
- **Broadband Service Providers: Broadband** service providers are entities that compete with existing cable systems using state-of-the-art systems that offer a bundle of telecommunications services, including video, voice, and high-speed Internet access. RCN is the largest BSP, serving approximately 507,000 subscribers. WideOpenWest (“WOW”) is the second largest BSP with cable systems serving about 313,000 subscribers. The third largest BSP is Knology, which currently serves approximately 120,000 subscribers.
- **Internet Video:** As of June 2002, an estimated 54 million Americans subscribed to an Internet access service, compared with 50 million as of June 2001. Real-time and downloadable video accessible over the Internet continues to become more widely available and the amount of content also is increasing. Despite the evidence of increased interest in Internet video deployment and use, the medium is still not seen as a direct competitor to traditional video service.
- **Home Video Sales and Rentals:** The FCC considers the sale and rental of home video, including videocassettes, DVDs, and laser discs, part of the video marketplace because they provide services similar to the premium and pay-per-view offering of MVPDs. About 90 percent of all U.S. households have at least one VCR. The number of homes with DVD players has grown rapidly since their introduction, with 14 million DVD homes by the end of 2001. The newest home video technology is the personal video recorder (“PVR”). One source reports that one million homes currently have PVRs.
- **Electric and Gas Utilities:** Several electric and gas utilities continue to move forward with ventures involving multichannel video programming distribution. Some of their characteristics, such as ownership of fiber optic networks and access to public rights-of-way, make them competitively significant. Some utilities offer telecommunications services on their own, while others partner with broadband service providers, such as Starpower, RCN’s joint venture with PEPCO. It also appears that utilities, particularly municipal utilities in rural areas, are willing to build advanced telecommunications networks to offer a full range of services where incumbent cable operators and telephone companies are not. Reports indicate that 450 public power systems offer communications services, up from 357 offering service last year.

## **Additional Findings**

- **Consolidations and Clustering:** Consolidation within the cable industry continues as cable operators acquire and trade systems. The ten largest operators served about 85 percent of all U.S. cable subscribers. In terms of one traditional economic measure, national concentration among the top MVPDs has decreased since last year as the largest MSOs continue to become more equal in size, and it remains below the levels reported in earlier years. DBS operators DirecTV and EchoStar rank among the five largest MVPDs in terms of nationwide subscribership along with three cable multiple system operators (“MSOs”). As of June 2002, a little more than 52 million of the nation’s cable subscribers were served by systems that are included in regional clusters.
- **Programming Networks:** The number of satellite-delivered programming networks has increased from 287 in 2001 to 308 in 2002. Vertical integration of national programming services between cable operators and programmers decreased 30 percent, after remaining steady at 35 percent over the last couple of years. In 2002, four of the top six cable MSOs held ownership interests in satellite-delivered programming services. Sports programming warrants special attention because of its widespread appeal and strategic significance for MVPDs. The *Ninth Annual Report* identifies at least 86 regional networks, 31 of which are sports channels, many owned at least in part by MSOs. There are also 32 regional and local news networks that compete with local broadcast stations and national cable news networks.
- **Program Access:** The program access rules adopted pursuant to the 1992 Cable Act, and recently extended by the FCC, were designed to ensure that other MVPDs can access vertically-integrated satellite delivered programming on non-discriminatory terms. The *Ninth Annual Report* notes that the terrestrial distribution of programming, including in particular regional sports programming, could have an impact on the ability of alternative MVPDs to compete in the video marketplace.
- **Advanced Technologies:** Cable operators and other MVPDs continue to develop and deploy advanced technologies, especially digital compression techniques, to increase capacity and enhance the capabilities of their transmission platforms. These technologies allow MVPDs to deliver additional video options and other services (e.g., data access, telephony, and interactive services such as video-on-demand) to subscribers.
- **Cable Modems and Navigation Devices:** There have been a number of technical developments regarding cable modems and navigation devices used to access a wide range of services offered by MVPDs. To date, CableLabs has certified more than 224 DOCSIS 1.0 compliant cable modems and 48 DOCSIS 1.1 compliant modems. CableLabs continues to advance development of the specification, releasing version 2.0 in January 2002. CableLabs is also continuing its efforts to develop next generation navigation devices with its initiative for the OpenCable Application Platform (“OCAP”) or “middleware” software specification. The specification, which was introduced in December 2001, is designed to enhance the ability of the consumer electronics industry to build and market integrated DTV sets, digital set-top boxes, and other navigation devices directly to consumers. One major television manufacturer, Panasonic, has signed the CableLabs POD-Host Licensing Agreement (“PHILA”), allowing it to develop, manufacture, and market digital televisions that will be able to receive high definition and other digital programs via cable, including premium services, without the use of set-top boxes.

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