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

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

FOURTH REPORT & ORDER AND
FURTHER NOTICE OF PROPOSED RULEMAKING

Adopted: December 18, 2007 **Released: February 11, 2008**

Comments due: (30 days after date of publication in the Federal Register)
Reply Comments due: (45 days after date of publication in the Federal Register)

By the Commission: Chairman Martin, Commissioners Copps and Adelstein, issuing separate statements; Commissioners Tate and McDowell, dissenting and issuing separate statements.

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I. INTRODUCTION

1. In this *Fourth Report and Order*, we set the Commission's cable horizontal ownership limit to prohibit cable operators from owning or having an attributable interest in cable systems serving more than 30 percent of multichannel video programming subscribers nationwide. Our decision implements the statutory directive that we impose a limit designed to ensure that no single cable operator or group of operators, because of its size, can unfairly impede the flow of programming to consumers.[1] Our action also responds to the court's concerns in *Time Warner Entertainment Co. v. FCC* ("*Time Warner II*"), that the Commission had failed adequately to justify the 30 percent limit.[2]

2. In establishing the 30 percent cable horizontal ownership limit, we rely on a modified "open field" approach to ensure that no single cable operator becomes so large that a programming network can survive only if that operator carries it. To calculate a horizontal limit that meets this test, we first determine the minimum number of subscribers a network needs in order to survive in the marketplace and then estimate the percentage of subscribers a network is likely to serve once it secures a

[1] 47 U.S.C. § 533(f)(2)(A).

[2] *Time Warner Entertainment Co. v. FCC*, 240 F.3d 1126 (D.C. Cir. 2001) ("*Time Warner II*").

carriage contract. The resulting calculation indicates that an open field of 70 percent and an ownership limit of 30 percent are necessary to ensure that no single cable operator is able to impede unfairly the flow of programming to consumers.

3. In the *Further Notice of Proposed Rulemaking*,[3] we seek further comment on (1) whether to retain the single majority shareholder attribution exemption, which currently applies to the cable and broadcast ownership rules; (2) whether, under the cable attribution rules, a limited partner may sell programming to the partnership and retain insulation; and (3) whether the Commission should clarify certain aspects of the cable Equity Debt ("ED") attribution rule, as it did for the broadcast Equity/Debt Plus attribution rule.[4] We also invite comment in the *Further Notice* on an appropriate channel occupancy limit, because the record evidence so far is inadequate to allow us to set such a limit.

II. FOURTH REPORT & ORDER

A. Background

4. The Cable Television Consumer Protection and Competition Act of 1992 ("1992 Cable Act") amended the Communications Act of 1934 ("Act" or "Communications Act") to promote increased competition in the cable television and related markets.[5] The 1992 Cable Act added structural rules intended to address the consequences of increased horizontal concentration and vertical integration in the cable industry.[6] Section 613(f) of the Act, added by the 1992 Cable Act, directs the Commission to conduct proceedings to establish reasonable limits on the number of subscribers a cable operator may serve ("horizontal limit") and the number of channels a cable operator may devote to its affiliated programming networks ("vertical," or "channel occupancy" limit).[7] A principal goal of this statutory

[3] This is the Second Further Notice of Proposed Rulemaking with respect to certain aspects of our attribution rules and the Third Further Notice of Proposed Rulemaking with respect to the channel occupancy limit.

[4] We ask that commenters submit comments regarding issues raised in the *Further Notice of Proposed Rulemaking* only in MM Docket No. 92-264, MM Docket No. 94-150, and CS Docket No. 98-82. We terminate MM Docket Nos. 87-154 and CS Docket No. 96-85. MM Docket No. 87-154 concerned the Commission's previous cross interest rules, which have long since been eliminated and replaced in part by the bright-line EDP attribution rule. The issues raised in MM Docket No. 87-154 have either been resolved or have been incorporated into MM Docket No. 94-150, the Commission's broadcast attribution review proceeding. *See 1995 Broadcast Attribution Notice*, 10 FCC Rcd 3606, 3612-12 ¶¶ 9-10 (1995). In CS Docket No. 96-85, the Commission initiated a rulemaking to amend its rules to implement provisions from the Telecommunications Act of 1996. The issues addressed in that rulemaking proceeding are unrelated to the matters addressed in this *Report and Order* and *Further Notice* and either have been resolved or incorporated into separate proceedings. *See Implementation of Cable Act Reform Provisions of Telecommunications Act of 1996*, CS Docket No. 96-85, *Order on Reconsideration*, 17 FCC Rcd 7609 (2002). Accordingly, in the interest of administrative efficiency, we are terminating these two proceedings. MM Docket No. 92-51 generally reviewed the Commission's policies affecting investments in the broadcast industry and sought comment on how attribution affects capital investment and new entry. While most of the issues raised in the proceeding were incorporated in MM Docket No. 94-150, there may be outstanding issues that have not been resolved. Therefore, we are severing MM Docket No. 92-51 from this proceeding.

[5] Cable Television Consumer Protection and Competition Act of 1992, Pub. L. No. 102-385, 106 Stat. 1460 ("*1992 Cable Act*"); H. R. REP. NO. 102-628 (1992) ("*House Report*"); Communications Act of 1934, 47 U.S.C. §§ 151, et seq. ("*Communications Act*").

[6] *Id*. § 613(f), 47 U.S.C. § 533(f).

[7] *Id.* ("In order to enhance effective competition, the Commission shall . . . conduct a proceeding . . . to prescribe rules and regulations establishing reasonable limits on the number of cable subscribers a person is authorized to reach through cable systems owned by such person, or in which such person has an attributable interest [and] to prescribe rules and regulations establishing reasonable limits on the number of channels on a cable system that can be occupied by a video programmer in which a cable operator has an attributable interest . . . ").

framework was to foster a diverse, robust, and competitive market in the acquisition and delivery of multichannel video programming.[8]

5. Congress intended the structural ownership limits of Section 613(f) to ensure that cable operators did not use their dominant position in the multichannel video programming distribution ("MVPD") market,[9] to impede unfairly the flow of video programming to consumers.[10] At the same time, Congress recognized that multiple system ownership could provide benefits to consumers by allowing efficiencies in the administration, distribution, and procurement of programming, and by providing capital and a ready subscriber base to promote the introduction of new programming services.[11]

6. The Commission first established a horizontal ownership limit in 1993, finding that a 30 percent limit would prevent the largest multiple system operators ("MSOs") from gaining enhanced leverage from increased horizontal concentration, while also ensuring that they could take advantage of economies of scale to encourage investment in new video programming services and deploy advanced services.[12] The Commission stated that a 30 percent horizontal ownership limit should protect against any single cable operator exerting undue power that could prevent the success of new video programming

[8] *See* S. REP. NO. 102-9 (1991) ("*Senate Report*"); *House Report* at 27; *see also* 1992 Act § 2(a)(4), (b)(1)-(5); 47 U.S.C. § 521 (a)(4), (b)(1)-(5).

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

[10] Communications Act § 613(f)(2)(A), 47 U.S.C. § 533(f)(2)(A). Congress directed that "[i]n prescribing rules and regulations . . . the Commission shall, among other public interest objectives . . . ensure that no cable operator or group of cable operators can unfairly impede, either because of the size of any individual operator or because of joint actions by a group of operators of sufficient size, the flow of video programming from the video programmer to the consumer . . . ensure that cable operators affiliated with video programmers do not favor such programmers in determining carriage on their cable systems or do not unreasonably restrict the flow of the video programming of such programmers to other video distributor . . . take particular account of the market structure, ownership patterns, and other relationships of the cable television industry, including the nature and market power of the local franchise, the joint ownership of cable systems and video programmers, and the various types of non-equity controlling interests . . . account for any efficiencies and other benefits that might be gained through increased ownership or control . . . make such rules and regulations reflect the dynamic nature of the communications marketplace . . . not impose limitations which would bar cable operators from serving previously unserved rural areas; and . . . not impose limitations which would impair the development of diverse and high quality video programming." Communications Act § 613(f)(2)(A)-(G), 47 U.S.C. § 533(f)(2)(A)-(G).

[11] *House Report* at 41, 43; *see also Senate Report* at 27, 33. In prescribing its rules and regulations, the Commission must "account for any efficiencies and other benefits that might be gained through increased ownership or control." 47 U.S.C. § 533(f)(2)(D).

[12] *Implementation of Sections 11 and 13 of the Cable Television Consumer Protection and Competition Act of 1992, Horizontal and Vertical Ownership Limits, Cross-Ownership Limitations, and Anti-trafficking Provisions*, 8 FCC Rcd 8565, 8567, 8577 ¶¶ 3, 25 (1993) (*1993 Second Report and Order*) (prohibiting cable operators from owning systems serving more than 30 percent of all homes passed by a cable operator); *see also id.* at 8569, 8582-84 ¶¶ 8, 37-42 (concluding that the 30 percent limit represented a careful balance between (1) limiting the possible exertion by a cable operator of excessive market power in the purchase of video programming; and (2) ensuring that cable operators are able to expand and benefit from the economies of size necessary to encourage investment in new video programming technology and the deployment of other advanced technologies). The Commission also stated that it intended to review the horizontal limit every five years in order to determine whether it was still reasonable under new market conditions and continued to meet the stated policy objectives. *Id.* at 8583 ¶ 40.

services or "unfairly impede the flow of video programming to the consumer."[13]

7. To better reflect changed market conditions and allow for internal growth in subscribership, in the *1999 Cable Ownership Order*, the Commission revised the 30 percent horizontal limit to permit a cable operator to serve 30 percent of all MVPD subscribers rather than 30 percent of all cable homes passed, as had been the case when the limit was first adopted.[14] As the Commission observed, including all MVPD subscribers rather than merely cable subscribers was equivalent to establishing a 36.7 percent cable subscriber limit.[15] It stated that the change was needed to reflect the growing impact of emerging non-cable MVPDs on the programming marketplace.[16] The Commission characterized its action as a "significant relaxation of the rule," which retained the "theoretical underpinnings" of its original 30 percent limit while taking account of marketplace changes by revising the relevant market definition to include all MVPD subscribers.[17]

8. The Commission reasoned that cable operators at certain concentration levels, "either by unilateral, independent decisions or by tacit collusion," could effectively prevent programming networks from entering or surviving in the marketplace simply by deciding not to carry a particular network, thereby impeding the flow of programming to the consumer.[18] Analyzing industry data, the Commission estimated that a new cable programming network would need access to 40 percent of the MVPD subscribers nationwide to be viable. A 30 percent limit, the Commission reasoned, would allow new programming networks access to a 40 percent "open field" by preventing the two largest cable operators from garnering more than 60 percent of the market.[19] In this regard, the Commission explained, "even if two operators, covering 60 percent of the market, individually or collusively deny carriage to a programming network, the network would still have access to 40 percent of the market, giving it a reasonable chance of financial viability."[20]

9. Cable operators filed a facial challenge to Section 613(f), contending that it violated the First Amendment, but the court in *Time Warner Entertainment Co. v. FCC* ("*Time Warner I*") rejected that argument.[21] With respect to the horizontal ownership limit, the court observed that Congress had identified two important governmental interests at stake: (1) ensuring that dominant cable operators do not "preclude new programming services from attaining the critical mass audience necessary to

[13] *1993 Second Report & Order*, 8 FCC Rcd at 8577 ¶ 26 (citing 47 U.S.C. § 533(f)(2)(A)).

[14] *Implementation of Section 11(c) of the Cable Television Consumer Protection and Competition Act of 1992 Horizontal Ownership Limits,* 14 FCC Rcd 19098, 19101 (1999) (*1999 Cable Ownership Order*) *see also Implementation of 11(c) of the Cable Television Consumer Protection and Competition Act of 1992 Horizontal Ownership Limits,* 13 FCC Rcd 14462, 14464-65 ¶ 4 (1998) ("*1998 Horizontal Reconsideration Order"*) (seeking comment on possible revisions to the horizontal ownership rules and the method by which horizontal ownership is calculated).

[15] *Id.*

[16] *1999 Cable Ownership Order*, 16 FCC Rcd at 19031.

[17] *Id.*

[18] *Id.* at 19114-16 ¶¶ 38-44.

[19] The 40 percent "open field" was based on the Commission's findings that in order to be viable, a new programming network needs access to approximately 15-20 million subscribers (20 percent of the market), and that, even with such access, it has only a 50 percent chance of actually reaching subscribers given tier packaging and consumer preferences. *See 1999 Cable Ownership Order*, 14 FCC Rcd at 19114-18 ¶¶ 40-50.

[20] *Id.* at 19119 ¶ 53.

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

survive";[22] and (2) preserving "diversity of information available to the public."[23] The court upheld the constitutionality of Section 613(f)(1)(A), finding that cable operators had "not demonstrated that the subscriber limits provision is on its face either unnecessary or unnecessarily burdensome."[24]

10. Cable operators subsequently challenged the Commission's specific horizontal limit. In *Time Warner II*, the court did not vacate the 30 percent horizontal limit, but found that the record did not adequately support that limit, and reversed and remanded to the Commission.[25] Addressing the Commission's open field approach, the court found that the Commission lacked evidence that cable operators would collude and that the Commission could not simply assume that cable operators would coordinate their behavior in an anticompetitive manner.[26] The court held that Section 613(f)(1) authorizes the Commission to set a limit to ensure "that no single company could be in a position singlehandedly to deal a programmer a death blow,"[27] but does not authorize the agency to regulate the "legitimate, independent editorial choices of multiple MSOs."[28] Without evidence that two operators might engage in joint anticompetitive conduct, the court concluded that the record would support a limit of 60 percent using the 40 percent open field premise.[29] The court cautioned that, in fashioning another limit, the Commission must recognize that market power depends not only on market share but also on the "*availability* of competition."[30]

11. The court suggested several ways that cable operators could unfairly impede the flow of programming, which might form the basis of a sustainable horizontal limit.[31] The court explained that the Commission might justify a limit by establishing that a single large cable operator acting alone could act anticompetitively by "extort[ing] equity from programmers or forc[ing] exclusive contracts . . . while serving somewhat less than [the market share] . . . that would allow it unilaterally to lock out a new cable programmer."[32] It found, however, that the Commission had failed to offer any evidence or theory of anticompetitive harm arising from the actions of a single cable operator.[33] Finally, the court criticized the Commission's finding that "[w]ith more MSOs making purchasing decisions, this increases the

[22] *Id.* at 1319.

[23] *Id.* at 1320.

[24] *Id.*

[25] *Time Warner II*, 240 F.3d at 1126. The court also reversed the Commission's 40 percent channel occupancy limit.

[26] *Id.* at 1130.

[27] *Id.* at 1131.

[28] *Id*. at 1135.

[29] *Id.* at 1132-33. The court found it unnecessary to reach the issue of whether the record supported the Commission's premise that new programmers would need access to an "open field" of 40 percent of U.S. subscribers. *Id*. at 1132.

[30] *Id.* at 1134 (emphasis in original).

[31] *Id.* at 1133.

[32] *Id.* We note that, in 1992, Congress instructed the Commission to adopt rules prohibiting cable operators from demanding equity in exchange for carriage. *See* 47 U.S.C § 536; 47 C.F.R. § 76.1301. Despite these protections, the court in *Time Warner II* recognized that "a single MSO, acting alone rather than 'jointly,' might perhaps be able to do so while serving somewhat less than the 60 percent of the market (*i.e.*, less than the fraction that would allow it unilaterally to lock out a new cable programmer) despite the existence of antitrust laws and specific behavioral prohibitions enacted as part of the 1992 Cable Act, *see* 47 U.S.C. § 536, and the risk might justify a prophylactic limit [horizontal cap] under the statute." *Time Warner II,* 240 F.3d at 1133.

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

likelihood that the MSOs will make different programming choices and a greater variety of media voices therefore will be available to the public," holding that that the Commission may not, on the basis of the diversity goal alone, adopt a limit that does more than ensure the availability of at least two conduits through which programmers may serve an adequate number of consumers.[34] The court found that a cable operator's size would constitute an unfair impediment to the flow of programming if that operator were the only viable conduit for programming "independent of concerns over anticompetitive conduct."[35]

12. In response to *Time Warner II*, the Commission sought comment on the status of the MVPD industry and various proposals for a new horizontal limit.[36] The Commission specifically sought information concerning the contractual relationships between programmers and cable operators in order to establish the extent of cable operators' market power and the effects of market power on the quantity and quality of programming, as well as the effects of market power on the programming costs of smaller MVPDs.[37] Commenters presented numerous arguments in response to the *2001 Further Notice*, but the record did not contain sufficient evidence to allow the Commission to set reasonable and sustainable horizontal and vertical ownership limits.[38]

13. In 2002, the Commission sought to obtain empirical data and information by conducting a programming network survey[39] and an experimental economics analysis,[40] and it sought comment on theoretical analyses designed to determine the relationship between bargaining power and buyer size in a bilateral bargaining environment.[41] The experimental economics analysis ("BKS Study") was designed to determine whether changes in MVPD concentration might impede the flow of programming to consumers by creating potentially problematic bargaining outcomes. The BKS Study created an experimental market that included many of the features of the actual market in which MVPDs and cable programming networks negotiate affiliate fees (*e.g.*, trades involving differentiated products, differences in the level of non-avoidable sunk costs incurred by buyers and sellers, and the use of a sequential bilateral bargaining process to negotiate fees). The study found that increasing concentration could impede the flow of programming, according to some measures of market performance. However, the BKS Study did not model some potentially important aspects of the industry (*i.e.*, vertical integration,

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[34] *Id.* at 1131-32, 1134.

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

[36] *Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992,* Further Notice of Proposed Rulemaking, 16 FCC Rcd 17312 17320-21 ¶ 7 (2001) ("*2001 Further Notice").*

[37] *Id.* at 17316-34 ¶¶ 2-45; 17338-47 ¶¶ 50-73; 17349-52 ¶¶ 76-84.

[38] *See The Commission's Cable Horizontal and Vertical Ownership Limits*, Second Further Notice of Proposed Rulemaking, 20 FCC Rcd 9374, 9385 ¶ 17 (2005) ("*2005 Second Further Notice*").

[39] *See* Letter from W. Kenneth Ferree, Chief, Cable Services Bureau, FCC, to Programming Network Owners (Feb. 15, 2002). The letter sought information from programming network owners for each network in which they had an interest, including the number of subscribers at the time the network became profitable, the number of subscribers at the end of calendar years 1997-2001, and information on the vertical integration status and genre of each network.

[40] Mark Bykowsky, Anthony Kwasnica, & William Sharkey, *Horizontal Concentration in the Cable Television Industry: An Experimental Analysis*, FCC Office of Plans and Policy, Working Paper No. 35 (June 2002 & rev. July 2002) ("*BKS Study*"). The BKS Study was released for public comment and generated a substantial record in response.

[41] Public Notice, Media Bureau Releases Two Staff Research Papers Relevant to the Cable Ownership Rulemaking and the AT&T-Comcast Proceedings, 17 FCC Rcd 19608 (MB 2002) (citing Nodir Adilov & Peter J. Alexander, *Asymmetric Bargaining Power and Pivotal Buyers*, FCC Media Bureau Working Paper No. 13 (Sept. 2002) ("*Asymmetric Bargaining Power*"); Nodir Adilov & Peter J. Alexander, *Most-Favored Customers in the Cable Industry*, FCC Media Bureau Working Paper No. 14 (Sept. 2002)).

retail competition from DBS, entry into and exit from the cable network programming industry.) Similarly, the theoretical work released by the Commission suggested that, under certain conditions, increased firm size can produce an improved bargaining position and adversely affect the flow of programming.[42] While these analyses of bargaining power show that increasing horizontal size imparts increased bargaining power to the largest buyer of video programming, they did not indicate the point at which such increased bargaining power is likely to impede the flow of programming to consumers.

14. In 2005, the Commission again sought comment to update and supplement the record.[43] The Commission observed that three significant events had changed the structure of the media industry since the close of the record on the *2001 Further Notice*: (1) the 2002 Comcast-AT&T cable transaction had resulted in one entity having a share of MVPD subscribers very close to the remanded 30 percent ownership limit;[44] (2) the 2003 News Corp.-Hughes transaction had created the first vertically integrated DBS operator, involving a number of video programming assets;[45] and (3) courts had remanded several media ownership rules, requiring that the Commission more firmly base its rules on empirical data and record evidence.[46] The Commission sought comment on the proposals in the record, recent developments in the industry, and certain tentative conclusions. It asked commenters to supplement the record where possible by providing new evidence and information to support the formulation of horizontal and vertical limits, and invited parties to undertake their own studies in order to further inform the record.[47] The Commission also sought comment on three analytical frameworks for determining whether, and at what level, a cable operator's size is likely to impede the flow of programming to consumers or diminish effective competition: (1) the open field approach, (2) an approach based on monopsony theory,[48] and (3) an approach based on bargaining power as a source of unilateral anticompetitive action. Finally, the Commission invited comment on Media Bureau Staff Research Paper No. 2004-1,[49] which examined the

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[42] *See generally Asymmetric Bargaining Power, supra* note 41, at 1-2, 8.

[43] *2005 Second Further Notice*, *supra* note 38.

[44] *See Applications for Consent to the Transfer of Control of Licenses, Comcast Corporation and AT&T Corp., Transferors, to AT&T Comcast Corporation, Transferee*, 17 FCC Rcd 23246 (2002) (*AT&T-Comcast Order*).

[45] *General Motors Corporation and Hughes Electronics Corporation, Transferors, and the News Corporation Limited*, *Transferee*, Memorandum Opinion and Order, 19 FCC Rcd 473 (rel. Jan. 14, 2004) ("*News Corp-Hughes Order*"*)*. The programming assets involved in the transaction included 35 owned and operated (O&O) full-power television broadcast stations, a national television broadcast network, ten national cable programming networks, and 22 regional cable programming networks.

[46] *Fox Television Stations, Inc. v. FCC*, 280 F.3d 1027 (D.C. Cir. 2002), *modified on rehearing*, 293 F.3d 537 (D.C. Cir. 2002) (remanding the Commission's retention of the then congressionally-established 35 percent national television ownership rule); *Sinclair Broadcasting Group, Inc. v. FCC*, 284 F.3d 148 (D.C. Cir. 2002) (*Sinclair*) (remanding the Commission's 1999 revision of its local television multiple ownership rule); *Prometheus Radio Project, et al. v. FCC*, 373 F.3d 372 (3rd Cir. 2004), *stay modified on rehearing*, No. 03-3388 (3rd Cir. Sept. 3, 2004), *cert. denied*, 545 U.S. 1123 (U.S. June 13, 2005) (Nos. 04-1020, 04-1033, 04-1036, 04-1045, 04-1168, and 04-1177) (remanding the cross-media limits, the local television multiple ownership rule, and the local radio ownership rule).

[47] *2005 Second Further Notice*, 20 FCC Rcd at 9385 ¶ 16.

[48] In a monopsony market, a large buyer has the market power to drive down prices. A monopsony market is sometimes referred to as a buyer's monopoly.

[49] Keith S. Brown, *A Survival Analysis of Cable Networks*, Media Bureau Staff Research Paper No. 2004-1 (rel. Dec. 7, 2004) ("*Media Bureau Survival Study*"). The *Media Bureau Survival Study* uses the statistical tools of survival or duration analysis to estimate how different variables affect a cable network's probability of survival and expected length of life. Using these results, the study estimates the number of subscribers a cable network needs for any given probability of survival over a given length of time. The *Media Bureau Survival Study* concludes, for example, that a network growing at an average rate requires approximately 42 million subscribers to have a 70 percent probability of (continued….)

effect of subscribership on a network's ability to survive in the marketplace.[50]

15. In response to the *2005 Second Further Notice*, commenters submitted new evidence and in some cases specific proposals. Parties advocating adoption of a limit at or below 30 percent submitted comments and economic analysis concerning the theories set forth in the *Notice* and proffered evidence related to programmer viability, the importance of distribution in top markets, the role of DBS in the programming and distribution markets, and the carriage decisions of the two largest multiple-system cable operators, Comcast and Time Warner.[51] These commenters advocate use of either an open field approach (CFA, CWA) or a monopsony analysis (MAP), with some urging discounting the market shares held by DBS (CFA) and consideration of the harmful effects of regional concentration and clustering (CFA, CWA, DirecTV, NAB).[52] In addition, the record includes three academic studies concerning the impact of ownership structure on the market for programming.[53] These papers argue that the largest cable operators already exercise monopsony power and engage in vertical foreclosure of rival networks and tacit collusion through reciprocal carriage of vertically integrated networks. In contrast, cable industry commenters (Comcast, Time Warner, NCTA, and the American Cable Association) and the Progress and Freedom Foundation ("PFF") support elimination of the cap.[54] They argue that the methodologies proposed for establishing a cap are flawed, that competition in the MVPD and video programming market prevents them from engaging in anticompetitive behavior, and that cable operators lack the incentive to collude.[55] Cable operators also argue that consumers will benefit from their larger size, due to the efficiencies gained from increased size and from a reduction in cable operators' costs resulting from the lower prices for programming purchased.[56] They claim that larger cable operators will tend to invest in cable systems with greater capacity, and therefore a national ownership cap could stymie the deployment of large-capacity systems and thereby increase the likelihood that video networks would fail to obtain widespread carriage.[57]

16. Below we review the record pertaining to each of the theories addressed in the *2005 Second Further Notice* and discuss the basis for our findings. We conclude that a modified open field approach

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survival over its first 10 years. The study was placed in the record of this proceeding concurrently with the release of the *2005 Second Further Notice*.

[50] *2005 Second Further Notice*, 20 FCC Rcd at 9385 ¶ 16.

[51] *See, e.g.,* TAC Comments to the *2005 Second Further Notice* at 13-23 (addressing carriage decisions of Comcast and Time Warner, programmer viability, and top-market distribution); CFA Comments to the *2005 Second Further Notice* at 69 (addressing the role of DBS in markets); Comcast Reply Comments to the *2005 Second Further Notice*, Ordover and Higgins Decl. at 8-9 (discussing impact of DBS on programming pricing).

[52] CFA Comments to the *2005 Second Further Notice* at 25-26, 69-70; CWA Comments to the *2005 Second Further Notice* 12-13; MAP Comments to the *2005 Second Further Notice* at 6-10, 29-35; DirecTV Comments to the *2005 Second Further Notice* at 5-9; NAB Reply Comments to the *2005 Second Further Notice* at 2-5.

[53] *See* Comments of Dong Chen, Jun-Seok Kong and David Waterman to the *2005 Second Further Notice*.

[54] *See* Comcast Reply Comments to the *2005 Second Further Notice* at 26; Time Warner Reply Comments to the *2005 Second Further Notice* at 9; NCTA Comments to the *2005 Second Further Notice* at 16-17; ACA Comments to the *2005 Second Further Notice* at 8 (suggesting elimination of the horizontal limit in smaller markets); PFF Comments to the*2005 Second Further Notice* at 46.

[55] *See, e.g.,* Comcast Comments to the *2005 Second Further Notice* at 13, 16, 60-69, 74-79. Comcast also claims that, absent record evidence of actual harms that the cap is designed to address, any horizontal ownership limit would be unduly burdensome and overly broad. Accordingly, it claims that a cap would violate the First Amendment under the intermediate scrutiny test applicable to cable ownership regulations. Comcast Supp. Comments at 23-24.

[56] *See, e.g., Id*. at 16, 74.

[57] Comcast March 16, 2007 Further Supp. Comments, Erdem, Katz, and Morgan Decl. at 34-35.

will best identify the point at which a cable operator's size is likely to unfairly impede the flow of programming to consumers.

B. Analytical Framework

1. Background

17. As noted above, the Commission has sought comment on three possible approaches to use in fashioning a horizontal ownership limit: (1) the open field approach, which examines whether one or more cable operators are large enough to effectively limit the viability of a programming network if they denied it carriage; (2) monopsony theory, which considers whether a cable operator has sufficient market power to restrict the price it pays for programming by purchasing less of it and thereby restrict the flow of programming to subscribers; and (3) bargaining theory, which examines the negotiations between the programming network and the cable operator in order to determine the point at which programmers will curtail their activities and thereby limit the quality and diversity of programming.[58] We discuss each of those approaches here and determine that the open field approach, suitably modified, represents the best method of determining an appropriate horizontal limit. We determine that monopsony theory does not apply to this market because of the lack of a single market price in the market for programming. Although we find that bargaining theory is useful in establishing the need for a limit, the record is insufficient to derive a specific limit using this theory.

a. The Open Field Approach

18. The open field approach determines whether a programming network would have access to alternative MVPDs of sufficient size to allow it to successfully enter the market, if it were denied carriage by one or more of the largest cable operators. The Commission adopted this approach in 1999 to set a 30 percent horizontal limit based on a theory that cable operators at certain concentration levels could effectively prevent programming networks from entering or surviving in the marketplace simply by deciding not to carry them.[59] The Commission found that a new programming network needs access to 15 to 20 million subscribers to be viable and that the typical programming network had only a 50 percent chance of actually serving all available MVPD subscribers.[60] The Commission concluded that a programmer needed to have an "open field" of 40 percent of MVPD subscribers nationwide and that a 30 percent MVPD subscriber limit would assure that a 40 percent open field remained even if the two largest cable operators decided not to carry it.[61] The Commission determined that calculations of the horizontal limit should include all MVPD subscribers, including non-cable MVPD subscribers, to take into account the increased market share of non-cable MVPDs.[62]

19. Several commenters support using an open field approach, and argue that it would produce a horizontal ownership limit of 30 percent or lower. CWA calculates that the appropriate limit is 27 percent of MVPD subscribers, based on an open field approach.[63] CFA states that the necessity of a horizontal limit of 20-30 percent is demonstrated by the open field approach.[64] In support of the open

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[58] *2001 Further Notice*, 16 FCC Rcd at 17338-47 §§ 52-74; *2005 Second Further Notice*, 20 FCC Rcd at 9417-26 ¶¶ 80-100. The Commission also sought comment on an appropriate channel occupancy limit. That issue is addressed below in the *Further Notice*, *see infra* Section III.

[59] *1999 Cable Ownership Order*, 14 FCC Rcd at 19117 ¶ 47.

[60] *Id*. at 19115-16 ¶¶ 42-43.

[61] *Id.* at 19119 ¶ 53.

[62] *Id.* at 19121 ¶ 57.

[63] CWA Comments to the *2005 Second Further Notice* at 12-13.

[64] CFA Comments to the *2005 Second Further Notice* at 69-70.

field approach, The America Channel provides an extensive discussion of the number of subscribers a programming network requires in order to remain viable, as well as information on the impact of large cable operators' programming decisions on the programming market.[65]

20. In contrast, other commenters claim that an open field approach cannot justify any horizontal limit.[66] For example, some commenters criticize the Commission's determination that a new network needs 15 million subscribers to survive in the marketplace, contending that many successful programming networks serve fewer than 15 million subscribers.[67] MAP urges the Commission to jettison the open field approach and use monopsony theory instead, claiming that Congress intended the ownership limit to address market power generally rather than create an open field for programmers.[68] NCTA asserts that the open field approach is too difficult to apply empirically because, it argues, gathering the average number of subscribers needed by programming networks with any precision would be very difficult.[69] Comcast contends that "no open field-based limit could be sustained because it is based on a series of arbitrary and unsupportable assumptions[,]"[70] a static market analysis, collusion theory, and a 40-60 million subscriber threshold for viability.[71]

b. Monopsony Framework

21. Monopsony theory examines whether a buyer has sufficient market power to force down the price it pays for a homogenous input by reducing its purchases, and whether this is inefficient, in a market with a single price for all units of the input purchased.[72] A firm acting as a buyer of an input is said to have monopsony power when it has the ability to establish the price at which input is purchased.[73] In the *Further Notices*, the Commission sought comment on the harms to the supply of programming that might result from the exercise of market power in a highly concentrated MVPD market.[74] The Commission asked at what level of concentration a large cable operator gains sufficient market power to be able to refuse carriage of programming for reasons other than consumer demand.[75] In 2005, the

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[65] TAC Comments to the *2005 Second Further Notice* at 13-23.

[66] *See* AT&T Comments to the *2001 Further Notice* at 61-68, Besen Decl. at ¶¶ 3, 11, 14, Ordover Decl. at ¶¶ 142-45; Time Warner Comments to the *2001 Further Notice* at 19-28; Time Warner Reply Comments to the *2001 Further Notice* at 14-18.

[67] AT&T Comments to the *2001 Further Notice* at 63-66, Besen Decl. at ¶¶ 3-6; Time Warner Comments to the *2001 Further Notice* at 24-26; Time Warner Reply Comments to the *2001 Further Notice* at 17-18.

[68] MAP Comments to the *2005 Second Further Notice* at 6-10.

[69] NCTA Comments to the *2005 Second Further Notice* at 14.

[70] Comcast Comments to the *2005 Second Further Notice* at 75.

[71] *Id.* at 74-79. Comcast apparently derives its 40-60 million subscriber threshold from a single statement in the *2005 Second Further Notice* describing CFA as believing that a "far greater open field may be necessary for competitive entry by a new programmer, as much as 30 to 40 million subscribers instead of the 15 million figure previously relied on by the Commission." *Id.* at 75 n.226 (citing *2005 Second Further Notice*, 20 FCC Rcd at 9417 ¶ 79). Comcast also argues that the purpose of Section 613(f)(1)(A) of the Act is to avoid anticompetitive behavior in the "wholesale" video programming market, and, thus, the Commission's focus on the economic success or failure of any particular video programmer in the marketplace is misplaced. Comcast April 4, 2007 *ex parte* letter at 2-3.

[72] *See,* e.g., Dennis Carlton & Jeffrey Perloff, MOD. INDUS. ORG. 105-07 (3d ed. 2000) ("Carlton and Perloff").

[73] In contrast, under perfect competition, no single buyer has the ability to affect the price at which an input is acquired.

[74] *2001 Further Notice*, 16 FCC Rcd at 17340 ¶ 57; *2005 Second Further Notice*, 20 FCC Rcd at 9420-23 ¶¶ 85, 87-88.

[75] *2001 Further Notice*, 16 FCC Rcd at 17328, 17340-41 ¶¶ 28, 58.

Commission generally sought comment on the appropriateness of applying standard monopsony arguments in this context,[76] and asked how monopsony power can be measured and whether certain observed industry practices and actions-- such as launch fees[77] and requests for equity in the programming network by the cable operator-- are indications that monopsony power is being exercised.[78] The Commission observed that the most significant challenge to the use of a monopsony model is the apparent requirement that there be a public market price that would be affected by a monopsonist's purchasing decisions.[79] Because the market for programming appears to be characterized by private bilateral negotiations yielding complex prices that are not made public, the Commission asked whether this means there is no market price that could be used in an application of the monopsony model.[80]

22. CFA and MAP claim that cable operators' large size enables them to exercise monopsony power in the purchase of programming. Citing to numerous economic and legal texts, CFA and MAP maintain that the theory of monopsony power is well-developed as the "flip-side" of the theory of monopoly power.[81] They assert that the theory of monopsony applies to the market for programming,[82] contending that a large cable operator will have the ability and incentive to hold down the price for programming, which will reduce the quantity of programming supplied.[83]

23. A published paper submitted by David Waterman provides an alternative model to the usual monopsony model to show how the exercise of monopsony power in the market for programming can reduce the flow of programming.[84] In Waterman's model, upstream suppliers have economies of scale in producing and distributing a differentiated input to downstream retail firms. Waterman states that this model is similar to the supply of cable network programming to cable companies. The downstream firms have an incentive to force the price down to the marginal cost of distribution and rely on other buyers to cover the fixed costs of producing the programming. According to Waterman, the ability of a buyer to "free ride" in such a manner depends on its bargaining power, which, in turn, depends on its size in the national marketplace. Based on his model, Waterman finds that, as the buyer grows in size in the national marketplace, its *incentive* to offer a lower price for programming declines somewhat (because there are fewer other buyers on which to free ride), but its *ability* to force the price down increases substantially.[85] The result of this effect, however, may be to reduce the revenues available to upstream suppliers, to the point that not all of the networks will be able to cover their fixed costs. The number of networks would then decline, reducing the product variety supplied to the downstream firms. Waterman notes that the negative externality on industry profits created by opportunistic input price setting can be internalized, either by vertical integration, or by industry-wide cooperative behavior (creating a large monopsony that controls the entire market).[86] In these two cases

[76] *2005 Second Further Notice,* 20 FCC Rcd at 9421 ¶ 87.

[77] In the case of a new programming network, an MVPD may demand that the programmer pay it for the right to access its subscribers (a practice sometimes referred to as a "launch fee"). *Id.* at 9421 n. 32.

[78] *Id.* at 9421-22 ¶ 88.

[79] *Id.* at 9422 ¶ 89.

[80] *Id*.

[81] CFA Comments to the *2005 Second Further Notice* at 62-67; MAP Comments to *2001 Further Notice* at 85-90.

[82] CFA Comments to the 2005 *Second Further Notice* at 67-68; MAP Comments to *2001 Further Notice* at 90-91.

[83] CFA Comments to *2005 Second Further Notice* at 61-62; MAP Comments to *2001 Further Notice* at 91.

[84] Comments of Dong Chen, Jun-Seok Kang and David Waterman to the *2005 Second Further Notice* (citing David Waterman, *Local Monopsony & Free Riders*, 8 INFO. ECON. & POLICY 337, 337-355 (1996) ("*Waterman Study*").

[85] *Waterman Study* at 339-41, 350-51.

[86] *Id.* at 350-51.

the buyer has an incentive to provide a price high enough to cover the fixed costs of networks, and will not attempt to free ride on other buyers' covering programming networks' fixed costs.

24. NCTA contends that there is no monopsony in the cable industry because every household has a choice of at least three MVPDs.[87] Comcast asserts that the monopsony model does not apply, because the supply of video programming must be characterized as a flat line rather than an upward--sloping supply curve. According to Comcast, the seller's marginal cost of supply is effectively zero, once first copy costs have been incurred.[88] Comcast notes that programming is purchased through individualized negotiation, and rather than walking away from a high price, it would continue negotiating until the parties agree on price.[89] Comcast also contends that it is impossible to compare the prices paid for programming, because prices are complex and differ for each transaction for a variety of reasons.[90] Finally, Comcast contends that if larger size allowed the cable operator to negotiate lower prices for programming, it would lower the cable operator's costs and consumers would reap the benefit.[91]

25. AT&T maintains that a cable monopsonist can only exist in a hypothetical world because real world video programming suppliers have many non-cable distribution alternatives.[92] AT&T adds that even if a cable monopsonist had the ability to insist on a price so low that a programmer would be forced either to exit the market or reduce its quality, the monopsonist would have no incentive to do so. AT&T states that an MSO's need for program quantity and quality is determined by consumer demand and retail competition, factors that it says are independent of the acquisition of monopsony power over programmers.[93] AT&T concludes that, regardless of its market power, MSOs seek programming that will draw the greatest number of viewers relative to the cost of the programming, and acquisition of monopsony power does not reduce the retail competitive pressures MSOs face.[94] AT&T submits that what remains is simply a private negotiation over how the two contracting parties will split the joint surplus that is created when the programmer agrees to sell programming to the MSO.[95]

c. Bargaining Theory

26. A branch of game theory, bargaining theory examines the determinants of a bargaining outcome, where outcome is defined in terms of whether a bargain is struck and, if struck, the share of the

[87] NCTA Comments to the *2005 Second Further Notice* at 7-8 (NCTA states that consumers have access to at least one cable operator and two DBS operators).

[88] Comcast Comments to the *2005 Second Further Notice* at 69-70; Comcast Supp. Comments at 15-16; Comcast March 16, 2007 Further Supp. Comments at 6. Joskow and McLaughlin maintain that cable operators do not have "textbook" monopsony power, because they lack "the critical element necessary to give firms monopsony power in input markets . . . that the buying firms individually face upward-sloping input (i.e., labor) supply curves and recognize that by buying fewer inputs they can reduce the *market price* that they pay for these inputs." Time Warner Comments to *the 2001 Further Notice*, Joskow & McLaughlin Decl. at 8-10 (emphasis in original).

[89] Comcast Comments to the *2005 Second Further Notice* at 71-72.

[90] *Id.* at 70. Comcast March 16, 2007 Further Supp. Comments at 6.

[91] Comcast Comments to the *2005 Second Further Notice* at 67, 74.

[92] AT&T Comments to the *2001 Further Notice* at 44, Ordover Decl. at ¶ 72. *See also* Comcast Supp. Comments at 16.

[93] AT&T Comments to *2001 Further Notice* at 44, Ordover Decl. at ¶ 74.

[94] AT&T Comments to *2001 Further Notice* at 44-45.

[95] AT&T Comments to *2001 Further Notice* at 45, Ordover Decl. at ¶¶ 72-76.

gains that accrue to each side of the bargain.[96] In 2001, the Commission suggested that excessive bargaining power could enable cable operators to force down the prices they pay to programmers, causing the programmers to curtail their activities and thereby limit the quality and diversity of programming.[97] In 2005, the Commission sought comment on the use of bargaining theory to establish a horizontal ownership limit.[98] Noting that bargaining theory is often used to model bilateral negotiations, the Commission suggested that, as compared to monopsony theory, bargaining theory may better describe and model the private negotiations and non-public terms of agreements typically employed in the purchase of programming by cable operators.[99] The Commission considered several possible sources of inefficiency that can occur when one side has significant bargaining power.[100] One potential source of inefficiency is the lower prices paid for programming where the supply of programming is competitive.[101] The low prices resulting from an excessive amount of bargaining power can prevent suppliers from recovering their fixed costs, causing them to exit the market or avoid entering with new programming. Another source of inefficiency is the "hold-up problem," in which suppliers underinvest in programming out of fear that if they commit themselves to making a substantial upfront investment in programming they will have a weaker bargaining position and will later be forced to accept lower prices.[102] The third source of inefficiency occurs when mutually beneficial trades fail to occur because the parties are uncertain about the size of the surplus available from a completed deal, and accordingly ask for too much.[103] The Commission asked whether an increasing level of concentration among cable operators is likely to reduce the bargaining power of programmers to such an extent that (1) programmers cannot recover their costs, (2) the hold-up problem is amplified, or (3) the likelihood of bargaining breakdown increases.[104] The Commission sought comment on which of these economic inefficiencies may rise to the level of reducing the flow of programming to consumers.

27. Comcast argues, based on a study it provides, that there is no evidence that increased concentration is likely to result in any of the proposed scenarios.[105] Instead, Comcast claims that if concentration has any effect at all, it is more likely to increase the ability of programmers to cover their costs, thereby encouraging the production of programming.[106] Cable industry commenters rely on the work of Alexander Raskovich[107] to support their position that large firm size could, in fact, weaken a cable operator's bargaining position. For example, AT&T suggests that increased firm size reduces the

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[96] *See*, e.g., JURGEN EICHBERGER, GAME THEORY FOR ECONOMISTS Ch. 9 (Academic Press, Inc. 1993); ERIC RASMUSEN, GAMES AND INFORMATION: AN INTRODUCTION TO GAME THEORY Ch. 10 (Blackwell Publishing, Inc. 1989).

[97] *2001 Further Notice*, 16 FCC Rcd at 17327 ¶ 26.

[98] *2005 Second Further Notice*, 20 FCC Rcd at 9423-24 ¶¶ 93, 94-95.

[99] *Id.* at 9422-23 ¶¶ 90-92.

[100] *Id.* at 9423 ¶ 93.

[101] *Id.*

[102] *Id.* at 9424 ¶ 94.

[103] *Id.* at 9424 ¶ 95.

[104] *Id.* at 9424-25 ¶ 96.

[105] Comcast March 16, 2007 Further Supp. Comments at 7-9, Erdem, Katz, and Morgan Decl. at ¶¶ 30-44.

[106] Comcast March 16, 2007 Further Supp. Comments at 6, 7-8, Erdem, Katz, and Morgan Decl. at ¶ 2.

[107] See Raskovich Comments to the *2001 Further Notice*, later revised and published as Alexander Raskovich, *Pivotal Buyers and Bargaining Position*, 51 J. OF INDUS. ECON. 4, 405-26 (Dec. 2003) ("Raskovich, *Pivotal Buyers and Bargaining Position*").

likelihood of hold-up, because a larger cable operator can less credibly threaten to free-ride than a smaller cable operator, because the larger operator stands to lose more if it fails to carry programming that consumers value.[108] Moreover, if a buyer becomes so large that it becomes "pivotal" to a supplier's production decision, the buyer cannot credibly abdicate responsibility for ensuring that the supplier's costs are covered. Time Warner, relying on Raskovich as well as a paper by Chipty and Snyder,[109] claims that the larger cable operators' decreased bargaining power results in larger operators "sharing in efficiencies that they have helped to create rather than exerting greater buyer market power."[110] Comcast also suggests that a cable operator would not exploit its bargaining power over programming for short-term gain because it would negatively affect its reputation and future programming negotiations.[111] NCTA concludes that the complexity of applying bargaining theory makes it difficult to determine the single point at which horizontal ownership would begin to have adverse effects on the programming market.[112]

2. Discussion

28. Open Field Analysis: We find that a modified open field approach best enables us to implement a horizontal ownership limit designed to prevent a single cable operator from unfairly impeding the flow of programming to consumers in such a way as to undermine the statutory objective to enhance effective competition. Our application of this approach will ensure that no single operator can create a barrier to a programming network's entry into the market or cause a programming network to exit the market simply by declining to carry the network. The *Time Warner II* court acknowledged that the exercise of editorial discretion by a single cable operator can unfairly impede the flow of programming if the operator is so large that its decision not to carry the network seals its fate.[113] The open field approach we adopt here results in a limit that ensures that the success of a programming network does not rely entirely on the carriage decision of a single cable operator. This approach prevents harms to the flow of programming caused by a number of possible factors, discussed below.

29. A cable operator may fail to carry a network valued by consumers for several reasons,

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[108] AT&T Comments to the *2001 Further Notice*, Ordover Decl. at ¶¶ 78-81; AT&T Comments to the *2001 Further Notice* at 47; *See also* Comcast March 16, 2007 Further Supp. Comments at 8, Ergam, Katz, and Morgan Decl. at ¶¶ 22-24.

[109] Tasneem Chipty & Christopher Snyder, *The Role of Firm Size in Bilateral Bargaining: A Study of the Cable Television Industry*, 81 REV. ECON. & STAT. 2, 326-40 (1999).

[110] Time Warner Comments to *2001 Further Notice*, Joskow and McLaughlin Decl. at 15. *See also* Comcast March 16, 2007 Further Supp. Comments at 9. Raskovich's model is a generalization of the work of Chipty and Snyder, who construct a bargaining framework in which a program seller engages in simultaneous bilateral bargaining with multiple program buyers. Raskovich amended the model of Chipty and Snyder to include pivotal buyers, that is, buyers without whom sellers would produce zero output. Assuming that there is an even split between buyers and seller (i.e., 50 percent-50 percent of a trade's surplus), Raskovich demonstrated conditions under which the pivotal buyer finds its bargaining position worsened. Raskovich posited a situation in which a buyer becomes so large through merger that only the buyer can cover the seller's cost of producing programming. In this context, the programmer's surplus from bargaining with the single large cable operator would be greater than the sum of the surpluses the programmer would receive from the two buyers prior to the merger. This implies that once a cable operator reaches a sufficient size, its payments to programmers will increase. Raskovich, *Pivotal Buyers and Bargaining Position, supra* note 107 at 3-4; *2005 Second Further Notice*, 20 FCC Rcd at 9425 ¶ 98.

[111] Comcast March 16, 2007 Further Supp. Comments at 8, Erdem, Katz, and Morgan Decl. at ¶ 25.

[112] NCTA Comments to the *2005 Second Further Notice* at 13.

[113] *Time Warner II*, 240 F.3d at 1135 ("The statute goes further, plainly treating exercise of editorial discretion by a single cable operator as 'unfair' simply because that operator is the only game in town.").

including reasons related to market failures.[114] For example, if there is asymmetric information about the costs and value of the network, inefficient trading will result, and negotiations can break down.[115] Thus, a network might not be carried by a cable operator because the parties cannot agree to a price, even though consumers value it and both the programmer and the cable operator would profit from the deal. Second, the cable operator may mistakenly believe that the network will not be popular with consumers. The open field approach ensures that a single operator's mistake in judgment will not prevent a valued network from reaching consumers.

30. Cable operators may also fail to carry programming valued by consumers for reasons unrelated to the dynamics of marketplace competition. For example, a large cable operator may prefer to carry only that programming whose content reflects its viewpoint and tastes. One of the Commission's goals is to maintain diversity of programming in the marketplace.[116] In addition to our competitive analysis, therefore, we have considered how the horizontal limit serves the public interest by promoting diversity of programming in the MVPD market.[117] As the *Time Warner II* court recognized, in promoting this goal, the Commission "is on solid ground in asserting authority to be sure that no single company could be in a position singlehandedly to deal a programmer a death blow."[118] If it can profitably sell its programming to multiple cable operators with different viewpoints and tastes, a network will not be pressured to make changes in the content and viewpoint of its programming to suit the desires of the largest cable operator. Our horizontal limit, and the framework supporting it, ensure that the largest cable operator will not be so large that the operator's failure to carry a network will prevent that network from entering or surviving in the market.

31. We conclude that the traditional models of monopsony and bargaining theories as applied to the available evidence are unable to predict the point at which an increase in cable operator concentration will unduly restrict the flow of programming. We find that the necessary assumptions for a traditional monopsony model do not hold in the programming market and that bargaining theory is

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[114] We define a "network valued by consumers" as a network for which consumers' willingness to pay exceeds the cost of the network.

[115] The Myerson-Satterthwaite theorem says that if both parties have incomplete information about both the cost and value of the good, even if trade would likely be beneficial, there exists no efficient bargaining process. Jean Tirole, THE THEORY OF INDUS. ORG. 22-23 (THE MIT PRESS 1988); Roger Myerson and M. Satterthwaite, *Efficient Mechanisms for Bilateral Trading*, 28 J. OF ECON. THEORY 265, 265-81 (1983). Akerlof's famous used car example demonstrates that if there is uncertainty about the value of a product, under certain conditions no deal will be reached even though both parties would benefit from it. This problem is known as adverse selection, in which uncertainty about sellers' quality can cause market quality to decline to the lowest level, or prevent the market from functioning at all. Carlton & Perloff, *supra* note 72 at 423-25 (for example, in a market with high and low quality goods offered, in which only the sellers know the quality of the goods, then only the lowest quality goods will be sold. This is because buyers will only offer a price that reflects the average value of the goods, which the sellers of the high quality goods will reject because it is less than the value of their goods.); George A. Akerlof, *The Market for 'Lemons': Quality Uncertainty and the Market Mechanism,* 84 Q. J. OF ECON. 488-500 (1970).

[116] In setting the horizontal limit adopted herein, we have focused primarily on the competitive dynamics of the multichannel video programming marketplace. Additionally, we have considered how the horizontal limit serves the public interest by promoting diversity of programming in the multichannel video programming market. *See Time Warner II*, 240 F.3d at 1134-36 (instructing that the Commission may set a horizontal limit based in part on diversity of programming outlets when it sets a limit primarily designed to achieve Congress' directive of promoting fair and effective competition).

[117] *See Time Warner II*, 240 F.3d at 1134-36 (instructing that the Commission may set a horizontal limit based in part on diversity of programming outlets when it sets a limit primarily designed to achieve Congress' directive of promoting fair and effective competition).

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

inadequate for determining whether specific harms to the programming market are likely to result from an increase in bargaining power by cable operators. Thus while a number of likely harms to the flow of programming can be identified, the traditional economic theories of monopsony power and bargaining are not useful for setting a limit in these circumstances.

32. Monopsony Model: We agree with those commenters who argue that the traditional monopsony model is not useful in analyzing the impact of cable operators' market power on the flow of programming.[119] The usual requirement for a monopsony model to be employed – that the supply of programming for each firm be sensitive to a market price (thus yielding an upward-sloping supply curve) – does not hold here. Under the traditional monopsony model, a monopsonist, because it is the only buyer, has the ability to set the price at which its desired input is acquired. And because of the existence of an upward sloping supply curve, it achieves a lower price by restricting the quantity of that input it acquires. In the market for programming, however, negotiations between programmers and cable operators are bilateral and largely confidential.[120] Thus for every potential purchase that could yield a positive benefit to consumers, the cable operator has an incentive to negotiate a price and purchase the programming.[121] From the perspective of a cable operator, agreeing to a higher price in a particular transaction for programming that has a higher cost may not raise the cost of purchasing programming from other sellers, as would occur in the usual monopsony model. In addition, the negotiated prices are complex and difficult to compare.[122] Thus, there is no market price to be affected, and the usual incentive for a firm to exercise monopsony power does not occur in this market. In any event, even assuming that monopsony theory could be applied to this market, the record before us is inadequate to make a determination of the relevant market price.

33. We agree with Ordover and Higgins's contention that Waterman's model of monopsony, in which a large buyer with market power may attempt to pay only for the distribution costs and not for the fixed costs of producing programming, also does not apply here. As Ordover and Higgins note, the existence of most favored nation clauses ("MFNs") in many programming contracts prevents one MVPD from gaining a lower price than other MVPDs for the same programming. This eliminates cable operators' ability to free ride on other MVPDs' paying for the fixed costs of creating the programming.[123] In addition, Waterman assumes that MVPDs are local monopolists and have no competition at all from other MVPDs for subscribers. Yet competition from DBS and other MVPDs limits, at least to some extent, a cable operator's ability to force programmers to accept low prices.[124] Waterman's model also fails to reflect other realities of the programming market by assuming that negotiations are simultaneous, that there is complete information about pricing, and that the profit split between programmers and MVPDs is fixed and not subject to later renegotiation.

34. Bargaining Theory: Because of its ability to incorporate the key market-specific and transaction-specific factors that typically characterize negotiations for the purchase of programming,

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[119] *See, e.g.*, AT&T Comments to *2001 Further Notice* at 42-45, Ordover Decl. at ¶¶ 66-67, 70-71.

[120] *See* Letter from Richard Ramlall, Sr. Vice President, External and Regulatory Affairs, RCN Corp., to Chairman Martin and Commissioners Adelstein, Copps and Tate in MB Dkt. No. 05-192, at 6, transmitted by letter from Jean Kiddoo, Bingham McCutchen to Marlene H. Dortch, Secretary (May 19, 2006) ("Programmers currently impose restrictive confidentiality and non-disclosure requirements on their contracts which foreclose other buyers from knowing whether the rates, terms and conditions offered them are consistent with the rates, terms and conditions provided to affiliated multichannel video programming distributors (MVPDs) and larger competitors.").

[121] Comcast Comments to *2005 Second Further Notice* at 71-72.

[122] *Id*. at 70.

[123] Comcast Reply Comments to *2005 Second Further Notice*, Ordover and Higgins Decl. at 7-8.

[124] *See Id*. at 8-9.

bargaining theory may be better able than monopsony theory to describe and model the programming market. We determine that bargaining theory does identify some of the harms likely to occur from the exercise of market power by a large cable operator. In particular, bargaining theory points out that even if both parties have an incentive to negotiate an agreement, and both parties would benefit from an agreement, bargaining can break down if there is asymmetric information (i.e., uncertainty about the cost of the network and its value to consumers), resulting in the programmer failing to gain carriage.[125] Thus the rules we craft to ensure the flow of programming must take into consideration the possibility that a network valued by consumers will fail to gain carriage. In addition, bargaining theory shows that a cable operator with greater bargaining power can obtain lower prices than it would otherwise.[126] This would have the effect of reducing programmers' incentive to enter the market and to invest in high-quality programming.[127]

35. We find, however, that bargaining theory is not useful for setting a horizontal limit, because it cannot be applied specifically to determine at what particular level of concentration these harms are likely to occur. The results of the models used in bargaining theory are very sensitive to the particular circumstances of the transaction. Thus, whether or not a particular programming network is carried depends on a variety of factors specific to its negotiations with each cable operator. This makes it difficult to develop market-wide results relating market concentration and the general flow of programming using a theoretical bargaining model.[128] Indeed, no commenters have proposed a reliable means of using bargaining theory to determine the horizontal limit needed to prevent the harms identified.

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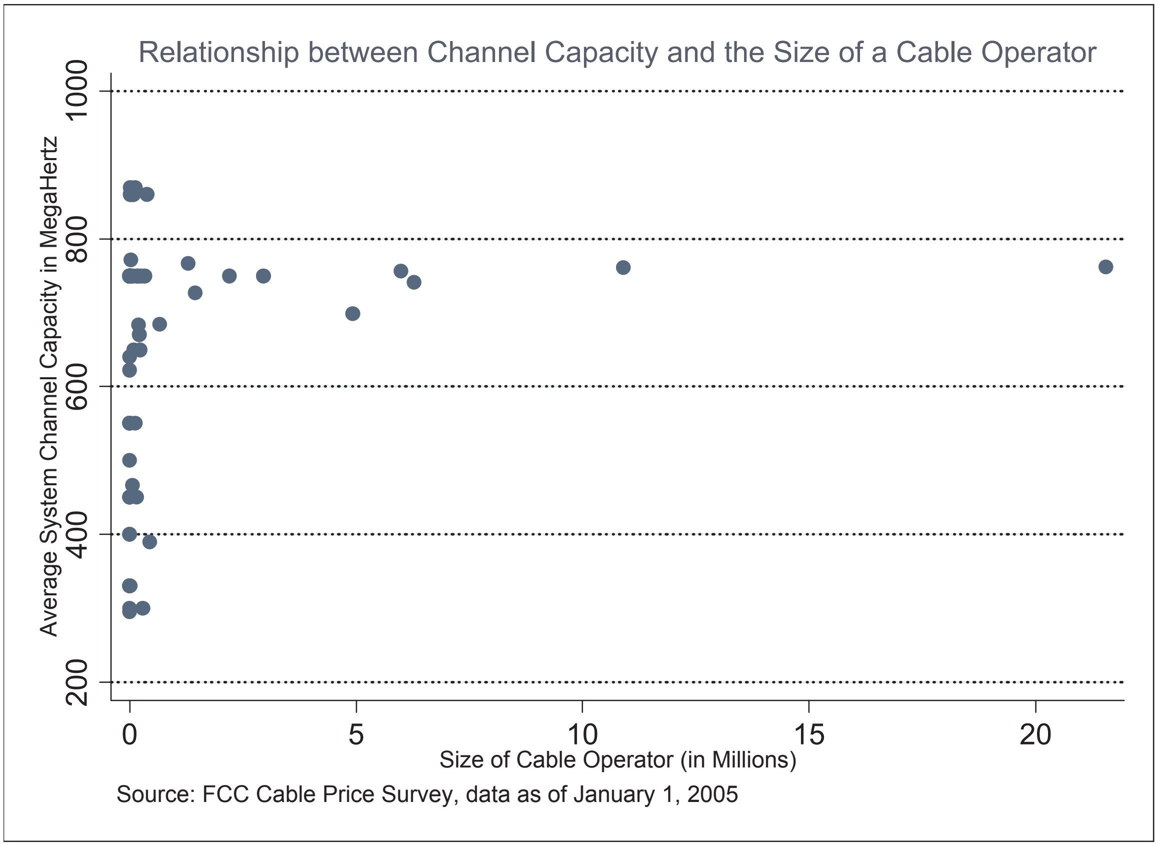
[125] *2005 Second Further Notice*, 20 FCC Rcd at 9424 ¶ 95, n.341. *See supra* note 115 (discussing the Myerson-Satterthwaite theorem). We note that there are numerous examples of popular networks not gaining carriage because of a breakdown of negotiations, such as MASN failing to get carriage on Comcast in Washington, D.C. in 2005, and YES not getting carriage on Cablevision in New York in 2002. *See Applications for Consent to the Assignment and/or Transfer of Control of Licenses Adelphia Communications Corporation, (and subsidiaries, debtors-in-possession), Assignors, to Time Warner Cable Inc. (subsidiaries), Assignees; Adelphia Communications Corporation, (and subsidiaries, debtors-in-possession), Assignors and Transferors, to Comcast Corporation (subsidiaries), Assignees and Transferees; Comcast Corporation, Transferor, to Time Warner Inc., Transferee; Time Warner Inc., Transferor, to Comcast Corporation, Transferee*, 21 FCC Rcd 8203, 8286 ¶ 186 (2006) ("*Adelphia Order*"); *News Corp.-Hughes Order*, 19 FCC Rcd at 539, 546 ¶¶ 140, 158.

[126] *2005 Second Further Notice*, 20 FCC Rcd at 9423 ¶ 93. Comcast's argument that consumers will benefit from the cable operator's ability to lower its costs only holds in particular circumstances. *See supra* ¶ 24; Comcast Comments to *2005 Second Further Notice* at 67, 74. Consumers may not benefit if the reduced costs are not passed through, or if the cable operator uses its bargaining power to exclude competitors from obtaining the network. *See Adelphia Deal May Cut Time Warner's Programming Cost, but Not Consumer's Bills*, NEW YORK TIMES, July 31, 2006, at C6 (it is not guaranteed that lower programming costs are passed through to consumers). The economics literature suggests that if prices are non-linear (i.e., where there is a non-constant relationship between price and quantity), increases in the bargaining power of a cable operator relative to that of a programmer may make consumers worse off. *See* Leslie Marx & Greg Shaffer, *Upfront Payments and Exclusion in Downstream Markets* RAND J. OF ECON. (forthcoming 2007) (available at http://faculty.fuqua.duke.edu/~marx/bio/papers/upfront.pdf).

[127] We note that it is not clear that cable operators pass on their lower programming costs to consumers in the form of lower subscription prices. *See, e.g., Adelphia Deal May Cut Time Warner's Programming Cost, but Not Consumer's Bills*, NEW YORK TIMES, July 31, 2006, at C6.

[128] Monopsony theory, on the other hand, does provide in principle such a link between market concentration and harms. As discussed above, we have determined that the traditional monopsony models do not appropriately describe the programming market, and therefore are not useful for our analysis. *See supra* ¶ 13 (stating that the *BKS Study* did not model some potentially important aspects of the industry [i.e., vertical integration, retail competition from DBS, entry into and exit from the cable network programming industry, or differences in MFN agreements across different-sized buyers]).

36. Horizontal Limit Concerns: We reject the proposition that a horizontal limit will reduce carriage of cable networks. Erdem, Katz and Morgan contend that an ownership cap will likely reduce the largest cable operator's investment in system capacity and therefore increase the probability that cable networks will fail to obtain widespread carriage.[129] They hypothesize that larger cable operators will invest in cable systems with greater capacity. They conclude that a limit on the size of the operator will increase the probability that cable networks will fail to gain widespread carriage. We disagree. As the following graph illustrates, once cable operators exceed one million subscribers, there is very little change in the average capacity of their cable systems.[130] Thus, we have no reason to believe that an increase in the size of the largest cable operator would lead to an increase in the system capacity of that operator. In fact, as the graph indicates, the average system capacities of the largest cable operators do not exceed the average system capacities of some of the smaller cable operators.



37. We are not persuaded that a horizontal cap will prevent cable operators from realizing economies of scale. Erdem, Katz, and Morgan argue that an ownership limit would check the realization of economies of scale and therefore deprive consumers of the lower prices and higher quality that would be associated with the economies of scale.[131] However, commenters do not provide any evidence that incremental economies of scale are likely to exist for cable operators that exceed the ownership limit. If

[129] Comcast March 16, 2007 Further Supp. Comments, Erdem, Katz, and Morgan Decl. at 34-35.

[130] Data from 2006 Cable Price Survey. *Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992*, *Statistical Report on Average Rates for Basic Service, Cable Programming Service, and Equipment*, 21 FCC Rcd 15087 (2006).

[131] Comcast March 16, 2007 Further Supp. Comments, Erdem, Katz, and Morgan Decl. at 64-65.

national subscriber reach above 30 percent were an important factor to cable operators to achieve economies of scale, we would expect to see multiple cable operators at or near 30 percent subscriber reach. Instead, however, we see many cable operators with far fewer subscribers and only one operator with a near 30 percent subscriber reach.[132] Furthermore, to the extent that these economies of scale are realized not through the number of total subscribers a cable system serves, but rather through increased clustering of cable systems in given areas, the ownership limit does not curb cable operators' ability to cluster their systems, because we have not placed any limits on the size of a cable operator in specific geographic locations.

38. NCTA argues that a horizontal cap will put cable operators at a disadvantage in competing with the largest telephone companies, including AT&T and Verizon, for offering telephony, Internet, and video programming services ("the triple play").[133] We do not believe that the ownership limit places cable operators at a significant disadvantage relative to large telephone companies such as AT&T and Verizon. As of June 2006, AT&T, the largest LEC, provided 35.2 percent of the end-user switched access lines in the United States, while Verizon, the second largest LEC, provided 23.8 percent of lines.[134] We expect the market share of these companies to decline due to the increased competition in the telephony segment.[135] The largest cable operators and telephone companies are evenly matched in terms of the number of broadband subscribers they serve.[136] With respect to telco entry into the MVPD market, their current plans suggest that they will pass fewer homes than the number of subscribers of the largest cable operator.[137]

39. We also disagree with the conclusions that Hazlett derives from his econometric analysis of the revenues of cable programming networks. The analysis purports to show that past increases in size of the largest cable operator have not been associated with a statistically significant decline in licensing fees obtained by cable programming networks, and, therefore, further increases in size are unlikely to cause any harm to cable programming networks' revenues.[138] Since the Commission began tracking cable operators' ownership statistics in 1996, no cable operator has served more than 30 percent of all MVPD

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[132] *See* Relationship between Channel Capacity and the Size of a Cable Operator, *supra* chart following ¶ 36.

[133] NCTA March 16, 2007 ex parte at 5-6. In NCTA's filing, it refers to Regional Bell Operating Companies ("RBOCs"), but we refer to them as Local Exchange Carriers or "LECs."

[134] *Local Telephone Competition: Status as of June 30, 2006*, released January 31, 2007 (available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-270133A1.pdf) and *Selected June 30, 2006 Data Filed for the Incumbent Local Exchange Carrier Operations of the Regional Bell Operating Companies* (available at http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/RBOC_Local_Telephone_June_2006.xls). For the purpose of this calculation, the end-user switched access lines for AT&T and BellSouth have been aggregated in order to estimate the post-merger size of AT&T. *See In the Matter of AT&T Inc. and BellSouth Corp., Application for Transfer of Control*, 22 FCC Rcd 5662 (2007).

[135] AT&T reports that "operating income continued to be pressured by access line declines due to increased competition, as customers disconnected both primary and additional lines and switched to competitors' alternative technologies, such as wireless, VoIP and cable for voice and data." AT&T Inc. SEC Form 10-Q for the quarterly period ended June 30, 2007 at 23.

[136] AT&T has 13.3 million broadband customers, Comcast has 12.4 million customers, Verizon has 7.7 million customers, and Time Warner has 7.2 million customers. *2nd Quarter 2007 Wrap-Up*, The Bridge Vol. 35, No. 6 (August 28, 2007) (available at http://www.thebridgemediagroup.com/media/archives/2Q_BR082807.pdf).

[137] AT&T's U-verse video service is projected to pass 18 million homes by the end of 2008 and Verizon's FiOS video service is projected to pass up to 15 million homes by 2009. *Standard & Poors Industry Surveys, Broadcasting, Cable, & Satellite*, June 14, 2007.

[138] Comcast March 16, 2007 Further Supp. Comments, Hazlett Decl. at 18-21.

subscribers, so we would expect to find no harmful effect so far.[139] Hazlett's focus on the more successful programming networks in this econometric analysis, his financial event study, and his discussion of examples of cable network formation provided later in his study are also likely to bias his results, because his analysis does not reflect the experiences of less-successful cable networks.[140] His reliance on cable network licensing fees and profits as a measure of the openness of the market also fails to account for other factors that speak to the ability of a single cable operator to force a network to exit from the market in the first five years of its existence.

C. Establishing the Horizontal Limit

40. In this section we calculate the ownership limit using the modified open field approach. The resulting limit will ensure that no single operator can, by simply refusing to carry a programming network, cause it to fail. The individual elements of this approach account for the factors that govern a network's ability to obtain subscribers. The basic building block of the calculation is the minimum viable scale of a program network. This value represents the minimum number of subscribers a programming network requires in order to be viable. Because not all of an MVPD's subscribers receive access to all of the networks carried by the MVPD, the minimum viable scale must be modified to determine how many of an MVPD's subscribers will also be subscribers to the program network. The subscriber penetration rate is used to make this determination. The resulting value is the total number of subscribers, to MVPDs that carry the network, necessary in order for the program network to serve the minimum viable scale. This value is then expressed as a percentage of the total number of MVPD subscribers to determine the fraction of the MVPD market that must agree to carry the program network so that it can serve the minimum viable scale. If there is no coordinated denial of carriage by MVPDs, this value would represent the open field necessary to give a program network a reasonable chance of serving the minimum viable scale.[141] Expressed as a formula, the ownership limit under the open field approach is:

$$Limit = \left(1 - \frac{MVS}{Pen} \cdot \frac{1}{Subs}\right)$$

[139] *See Implementation of Section 19 of the 1992 Cable Act, Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, *1996 Video Competition Report*, 12 FCC Rcd 4358 (1997); *1997 Video Competition Report*, 13 FCC Rcd 1034 (1998); *1998 Video Competition Report*, 13 FCC Rcd 24284 (1998); *1999 Video Competition Report*, 15 FCC Rcd 978 (2000); *2000 Video Competition Report*, 16 FCC Rcd 6005 (2001); *2001 Video Competition Report*, 17 FCC Rcd 1244 (2002); *2002 Video Competition Report*, 17 FCC Rcd 26901 (2002); *2003 Video Competition Report*, 19 FCC Rcd 1606 (2004); *2004 Video Competition Report*, 20 FCC Rcd 2755 (2005); *and 2005 Video Competition Report*, 21 FCC Rcd 2503 (2006). Hazlett's results on the effect of the market share of the largest MSO on the revenues of programmers are mixed. He finds that there is a negative effect, so that an increase in the size of the largest MSO depresses the revenues of programmers. Comcast March 16, 2007 Further Supp. Comments, Hazlett Decl at 21. However, the effect is not statistically different from zero at the reported levels of significance. The information, as presented by Hazlett, does not allow us to determine if the estimated magnitude of the impact would be financially significant to programmers. One possibility is that the estimated impact is financially significant, though the estimate is imprecise and therefore is not statistically significant. It would be preferable to have had the estimated impact expressed as a percentage of the revenue of programmers in order to determine whether this study merits additional study.

[140] This is the concern raised by Erdem, Katz, and Morgan regarding the *Network Survival Study*. Comcast March 16, 2007 Further Supp. Comments, Erdem, Katz, and Morgan Decl. at 36. While the *Network Survival Study* does include a substantial number of unsuccessful networks, Hazlett provides no indication that any failed networks are included in his sample.

[141] An allowance for coordinated action by MVPDs is also possible. This is implemented by dividing the open field by the number of MVPDs that are likely to engage in coordinated denial of carriage.

Three values are required in order to calculate the ownership limit: (1) total MVPD subscribers ("*Subs*"), (2) the minimum viable scale ("*MVS*"), and (3) the subscriber penetration rate ("*Pen*"). As described below, the resulting calculation indicates that an open field of 70 percent and an ownership limit of 30 percent are necessary to ensure that no single cable operator is able to impede unfairly the flow of programming to consumers.

1. Total Subscribers

41. The Commission originally calculated the ownership limit in terms of the fraction of cable homes passed.[142] In 1999, the Commission changed the methodology to use total MVPD subscribers in calculating the limit in order to account for the large and growing presence of competitors, particularly DBS.[143]

42. CFA contends that if the Commission chooses to continue using all MVPD subscribers in the calculation, DBS subscribers should be discounted by 10 percent to account for the reduced advertising revenues associated with carriage on DBS.[144] CFA notes that DBS draws more of its customers than cable does from rural markets, which are less valued by advertisers. The National Hispanic Media Coalition ("NHMC") supports the use of only cable subscribers in the calculation.[145] Comcast, on the other hand, suggests that the existing methodology fails to capture other relevant distribution outlets for video programming, such as international markets, the Internet, mobile phones, video on demand, digital video recorders, and home video sales and rentals.[146]

43. We will continue to use all MVPD subscribers when calculating the cable ownership limit. We estimate that as of June 2006, there were 95,784,478 total MVPD subscribers.[147] By including all MVPD subscribers, we account for the impact of the dynamic nature of the MVPD market on the viability of programming networks. DBS has grown dramatically since the Commission first established a limit in 1993. The recent entry of incumbent LECs into the MVPD marketplace may also have a significant effect on the role that cable operators play in the distribution of video programming. Programming networks can gain subscribers not only through distribution by cable operators but also through distribution by DBS operators and other MVPDs. The importance of taking these developments into account can be seen by comparing the maximum allowable size of a cable operator using total cable subscribers instead of total MVPD subscribers. If the limit were based solely on cable subscribers, the permitted maximum size of a cable operator would have been reduced from about 20 million subscribers in 2001 to about 19.6 million in 2005. In contrast, under a limit based on MVPD subscribers, the

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[142] *1993 Second Report and Order,* 8 FCC Rcd at 8576 ¶ 24.

[143] *1999 Cable Ownership Order*, 14 FCC Rcd at 19110 ¶ 27.

[144] CFA Comments to the *2005 Second Further Notice* at 69.

[145] *See* NHMC Comments to *2005 Second Further Notice* at 1 (evaluating the "current cable situation" in terms of numbers of cable subscribers served by major cable operators because it considers the two largest cable operators to be gatekeepers that determine the success of programming networks).

[146] *See* Comcast Comments to the *2005 Second Further Notice* at 22-34. *See also* Comcast Supp. Comments at 7-9; NCTA March 16, 2007 *ex parte* letter at 4.

[147] In the formula above, all MVPD subscribers will be used as the value for "Subs." Sources for individual elements are: (1) NCTA Comments in MB Docket No. 06-189 at 9; (2) Kagan Media Research, Media Trends 2006 at 64; (3) *C-Band Numbers Keep Dwindling, Satellite Business News FAXUpdate*, July 7, 2005; (4) The DIRECTV Group, Inc., SEC Quarterly Report Form 10-Q Pursuant to Section 13 or 15(d) of the Securities Act of 1934 for the Quarterly Period Ended June 30, 2006, at 31, (4) EchoStar Communications Corp., SEC Quarterly Report Form 10-Q Pursuant to Section 13 or 15(d) of the Securities Act of 1934 for the Quarterly Period Ended June 30, 2006, at 28; and (5) Commission estimates based on the Broadband Service Providers Association Comments in MB Docket No. 06-189 at 6. *Id. at* 2617-18 App. B, Table B-1.

maximum size of a cable operator would have increased slightly from about 25.8 million subscribers in 2001 to about 28.3 million in 2005. If the cap were based solely on cable subscribers, an operator at the limit would have had to divest subscribers at the very time it was facing increased competition and programmers were finding more distribution outlets open to them. Clearly a calculation using only cable subscribers would fail to address the dynamic nature of competition in the MVPD market by failing to account for significant MVPDs other than cable, whose market shares continue to grow.

44. We do not include mobile phones, the Internet, home video rentals, or international distribution in the total subscriber count. There is scant evidence in the record whether and how these alternative outlets affect the viability of a cable programmer.[148] Moreover, many of these alternative outlets operate based upon the existing popularity of the content, which is gained only through widespread distribution via MVPDs. Finally, including these types of outlets could result in double-counting or triple-counting the same consumers.

45. We reject CFA's suggestion that we discount DBS subscribers.[149] We note that the survival analysis used to develop the minimum viable scale of a programming network includes DBS, and other MVPD competitors, as outlets for programming. Thus, the survival analysis accounts for any impact of DBS on the viability of networks, including the effects of DBS distribution patterns or product characteristics, or any effect related to advertising differentials. Moreover, even assuming that DBS yields a lower advertising rate, it is not clear that DBS subscribers would always be less valuable to all programming networks. DBS carriage enables a programming network to serve subscribers in all parts of the country through a single provider, an advantage that may partially or completely offset the drawback of receiving a lower advertising rate. Discounting DBS subscribers would also represent a partial return to the Commission's pre-1999 methodology and run counter the court's admonition in *Time Warner II* that the Commission should account for the effect of DBS in constraining cable operators' market power.[150] As the court noted, the growth of DBS subscribership, although it has slowed in recent years, remains consistently faster than growth in cable subscribers.[151]

46. CFA maintained in response to the *2001 Further Notice* that the Commission should establish the limit as a percentage of cable homes passed.[152] CFA asserts that the statutory language calls for horizontal limits on the number of subscribers a cable operator is "authorized to reach." According to CFA, "[e]very home to which a cable operator can deliver service is a home which a franchised operator is 'authorized to serve.' Limiting the count to those who purchase the service ignores a large number of customers the operator is 'authorized to reach'."[153] Comcast proposes that the Commission include every American household in the denominator because it contends that DBS passes every home in the U.S.[154]

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[148] As discussed in the calculation of the minimum viable scale, however, the calculation does account for the effect of alternative revenue sources on network program viability. *See infra* ¶ 52. *See also* MAP March 21, 2007 *ex parte* letter at 2 (stating that DVDs and video iPods do not increase the availability of independent programming channels that would otherwise support new networks).

[149] *See* CFA Comments to the *2005 Second Further Notice* at 68-70.

[150] Addressing petitioners' arguments that the Commission failed to adequately account for competitive pressures from DBS, the D.C. Circuit stated that "in revisiting the horizontal rules the Commission will have to take account of the impact of DBS on that market power." *Time Warner II*, 240 F.3d at 1134. For a further discussion of the competitive effect of DBS, *see infra* ¶ 70.

[151] *Time Warner II*, 240 F.3d at 1133 (citing *2000 Video Competition Report*, 16 FCC Rcd 6005, 6008 at ¶¶ 6-8).

[152] Consumer Federation of America, Consumers Union, the Center for Digital Democracy, and the Media Access Project, CS Docket No. 98-82, et al. (Oct. 11, 2002) (CFA Oct. 11, 2002 *Ex Parte*).

[153] *Id.* at 4.

[154] Comcast Supp. Comments at 27-28.

47. We do not agree that the statute mandates adoption of a homes-passed standard for the calculation of the horizontal limit. Indeed, the Commission has already considered and rejected this approach. [155] Section 613(f)(1)(A) requires the Commission "to prescribe rules and regulations establishing reasonable limits on the *number of cable subscribers* a person is authorized to reach" through cable systems owned or attributed to such person.[156] Neither the statute nor the underlying legislative history requires a "homes passed" standard, and the Commission is not precluded from adopting a subscriber-based standard.[157]

48. As NCTA points out and we have recognized, cable operators negotiate with and purchase programming from video programmers based on the actual number of subscribers they serve, not the estimated number of homes passed within their franchise areas. [158] Therefore, cable operators' share of actual subscribers nationwide more accurately reflects their market power in the video programming market than the homes passed standard – using either cable homes passed or DBS homes passed. Moreover, in terms of "market structure," the Commission observed that although the breadth of cable operators' reach in terms of homes passed might be wide, their actual penetration in terms of homes served may be much lower, rendering the homes passed criterion an inaccurate measurement of their market power.[159] In view of DBS's current nationwide reach and the presence of cable overbuilders passing the same homes as cable, the homes passed standard not only has come to represent an inaccurate indicator of market power, it has become an unworkable standard.[160] As the same homes are passed by more than one MVPD, the homes passed standard inevitably results in double counting and renders it impossible to determine a cable operator's market share. A subscriber-based standard is a more accurate indicator of cable operators' size and market power in a dynamic and evolving communications marketplace. The adoption of the subscriber-based standard is consistent with and supports our decision to include the total MVPD subscribership in the calculation of the horizontal limit.

2. Minimum Viable Scale

49. In 1999, based upon an examination of the number of subscribers that successful networks had acquired, as well as industry comments, the Commission calculated that the minimum viable scale of a programming network was on the order of 15 million subscribers.[161] In 2005, the Commission sought

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[155] *Implementation of Sections 11 and 13 of the Cable Television Consumer Protection and Competition Act of 1992, Horizontal and Vertical Ownership Limits, Cross-Ownership Limitations and Anti-Trafficking Provisions*, 8 FCC Rcd 210, 217 ¶ 36 (1992) (stating that "the Commission may prescribe subscriber limits either as a share of cable subscribers or as a share of homes passed," since the 1992 Act does not define the term "reach" in the context of subscriber limits).

[156] 47 U.S.C. § 533(f)(1)(A)(emphasis added).

[157] NCTA suggests that the provision "authorized to reach," which the statute does not define, may be interpreted "simply means that the Commission is required to set limits on the number of subscribers a cable operator is 'permitted to serve' through owned and affiliated cable systems." NCTA Feb. 18, 2000 Opposition at 4. Language in the *Conference Report* supports the "permissive interpretation" NCTA suggests. The *Conference Report* states, in pertinent part, that: The Senate bill amends 613(f) of the Communications Act as follows: Subsection (f)(1) requires the FCC to establish reasonable limits on (A) the number of cable subscribers that any one cable operator may serve through cable systems owned by the operator or in which the operator has an attributable interest. H.R. Rep. No. 102-862 at 81 (1992) (*Conf. Rep.*); *see also Senate Report* at 80.

[158] *See* NCTA Feb. 18, 2000 Opposition at 6; *Sixth Annual Report*, 15 FCC Rcd at 1056 ¶ 175 and n.629; *1999 Cable Ownership Order*, 14 FCC Rcd at 19108 ¶ 22.

[159] *See 1999 Cable Ownership Order*, 14 FCC Rcd at 19108 ¶ 22.

[160] *See id* at 19108-09 ¶¶ 22-23; NCTA Oct. 23, 2002 *Ex Parte* at 2.

[161] *1999 Cable Ownership Order*, 14 FCC Rcd at 19115 ¶ 41.

comment on the number of subscribers a programming network requires in order to remain viable.[162] The Commission proposed that viability is partly a function of the time the network has been in the market, and that simply because recently-launched networks tend to have a limited number of subscribers early in the launch, does not mean that those networks will remain viable in the future with a limited number of subscribers.[163] Referring to the comments of programmers that were submitted in other proceedings, the Commission suggested that long term viability may require more than 40 million subscribers.[164]

50. Comments filed in response to the *2005 Second Further Notice* reflect a wide range of viability estimates. CFA, for example, states that increased programming costs necessitate that a network serve 50 to 75 million subscribers in order to reach long-run viability.[165] TAC asserts that there are two requirements for a new network to enter and survive in the marketplace: the ability to forecast distribution to 50 million households over five to seven years and access to the top television markets.[166] TAC contends that in order for a network to reach the survivability target of 50 million subscribers, a network first must reach the 20 million subscriber mark to obtain reliable Nielsen data.[167] It states that networks that cannot provide advertisers with reliable ratings data are extremely limited in their ability to generate ad revenue and will not survive in the market.[168] Observing that all of the cable networks with distribution to 25 million households or more are carried by both Comcast and Time Warner, TAC asserts that in order to exceed 25 million subscribers, a network must be carried by both MSOs.[169] TAC estimates that there is an open field of 53.4 million subscribers a network could reach without carriage by Comcast or Time Warner.[170]

51. NCTA contends that it is not possible to calculate a single value for the minimum viable scale of a network, asserting that even if the Commission were to calculate the average number of subscribers needed for a network to be viable, the calculation would be imprecise.[171] Erdem, Katz and Morgan argue that the average network may not be representative of the population of networks or

[162] *2005 Second Further Notice*, 20 FCC Rcd at 9414-20 at ¶¶ 74-84.

[163] *Id.* at 9415-16 ¶¶ 75-76.

[164] *Id.* at 9418-19 ¶ 82.

[165] CFA Comments to the *2005 Second Further Notice* at 10-11.

[166] TAC Comments to the *2005 Second Further Notice* at 13-18. According to CFA, the Commission should assign an advertising-weighted premium to the subscribers in the top markets when reviewing a specific transaction. CFA contends that without that adjustment, the "true market power of top-market clusters will be ignored to the detriment of consumers and programmers." CFA Comments to the *2005 Second Further Notice* at 68-70.

[167] TAC Comments to the *2005 Second Further Notice* at 20.

[168] *Id.*

[169] *Id.* at 21. TAC also emphasizes that of 92 national, non-premium cable programming networks that have succeeded in reaching 20 million households, "not a single one had achieved the 20 million household milestone without carriage by either Comcast or Time Warner, or both." *Id.* at 20.

[170] *Id.* at 21-22. TAC states, however, that if a network is denied carriage by both Comcast and Time Warner, it would need to be carried by every other MVPD and added to their basic analog tiers to reach the 50 million subscribers that advertisers require. In addition, TAC provides data suggesting that of 114 independent networks seeking national carriage, none has launched without carriage by Time Warner or Comcast, and the total numbers of independent networks actually launched are low. Id. at 22-23, 35-37. TAC defines "Independent Network" and "Unaffiliated Network" as "any Network without financial ties to Comcast, Time Warner, Viacom, News Corp, NBC Universal, Disney, or their subsidiaries." *Id*. at 34 n.46. TAC states that if Time Warner or Comcast deny carriage of a network, other cable operators will be less willing to dedicate channel capacity, marketing, and other resources to distribute the network because its survivability is in doubt. *Id.* at 22-23.

[171] NCTA Comments to the *2005 Second Further Notice* at 14.

potential networks.[172] They also question the public policy rationale of protecting networks' decisions to follow a high-cost strategy.[173] Comcast maintains that the minimum viable scale of a network is much lower than that suggested by other commenters and asserts that networks can launch and remain operational with far fewer than 40 to 60 million subscribers.[174] Comcast provides several examples of national programming networks that it claims are thriving with fewer subscribers, specifically, Bloomberg Television (34.1 million subscribers), DIY (31 million), Fine Living (25 million), Independent Film Channel (34.6 million), Fuse (36.8 million), and NFL Network (24 million).[175] In addition, Comcast asserts, the data supporting the Commission's 15 million subscriber threshold is outdated and unreliable, given the rapidly changing video programming marketplace.[176] Comcast states that many successful networks, including regional programming networks, serve fewer than 15 million subscribers.[177] Comcast adds that the video programming market is moving toward niche services that target specific demographics and do not require mass market distribution. Comcast also notes that the *Media Bureau Survival Study* indicates that "a network requires only 10.18 million subscribers from day one to have a survival probability of 70 percent over the first five years, and 13.94 million subscribers from day one to have a survival probability of 70 percent over its first ten years."[178] In response to TAC's arguments, Comcast contends that the absence of other programming networks as participants in the proceeding suggests that "programmers do not believe that horizontal or vertical cable ownership rules are necessary to ensure the flow of video programming to consumers."[179] Comcast disputes TAC's argument that independent programmers cannot obtain carriage from other MSOs without carriage by Time Warner and Comcast.[180] Hazlett provides a number of examples of independent programming networks that have successfully entered the market, some without carriage from the largest cable operators, or are planning on entering the market, as evidence that market participants still believe that entry is feasible for an independent network.[181]

52. In order to determine the minimum viable scale (MVS) of a programming network for

[172] Comcast March 16, 2007 Further Supp. Comments, Erdem, Katz, and Morgan Decl. at 33.

[173] *Id.* at 33-34.

[174] Comcast Comments to the *2005 Second Further Notice* at 75.

[175] *Id*.

[176] Comcast Supp. Comments at 11.

[177] Comcast Comments to the *2005 Second Further Notice* at 75-76. Comcast provides a list of 52 networks, including launch dates, that have fewer than 15 million subscribers. Comcast April 4, 2007 *ex parte*, at 3-4, App. A.

[178] Comcast Comments to the *2005 Second Further Notice* at 78-79. AT&T claims that because advertising supports programming, networks can be viable even if they reach fewer than 15 million MVPD subscribers. AT&T Comments to the *2001 Further Notice*, Besen Decl. at ¶ 3. More generally, AT&T asserts that the open field approach assumes that all services need the same size open field to achieve viability, when in reality the open field requirement is highly individualized and depends on the unique characteristics of each programming package. *Id*. at 62-65; *see also id*. at Besen Decl. at ¶¶ 3, 11, 14.

[179] Comcast Reply Comments to the *2005 Second Further Notice* at 5.

[180] Comcast asserts that its decisions to carry programming are based on the content and theme of the network, the necessity or desirability of its presentation as a linear network, the financing of the network, the experience and proven capability of the management team, the distribution secured by the network elsewhere, and the fees and terms of carriage and that TAC's lack of carriage is not attributable to unfair treatment by a particular MVPD or a structural problem in the industry. Comcast Reply Comments to the *2005 Second Further Notice* at 7-8.

[181] Hazlett cites the examples of Fox News Channel, Oxygen Television, American Life TV, The NFL Network, CSTV Networks, and The Sportsman's Channel as independent networks that have entered recently. Comcast March 16, 2007 Further Supp. Comments, Hazlett Decl. at 30-35.

purposes of calculating the ownership limit in the formula set out above, as previously proposed, we rely upon an analysis that estimates the probability that a programming network will continue to operate based on the number of subscribers it has at a point in time.[182] The Commission previously proposed using the methodology set forth in the *Media Bureau Survival Study* to calculate the minimum viable scale and sought comment on this proposal.[183] That study was based on survival analysis and is a standard method used in the fields of economics, biology, and engineering. The study accounts for all of the revenue sources that maintain the viability of the programming network, including international distribution, and reflects the impact of advertising revenues, which may vary based on the markets where the programming network is carried. It is based on an unbiased sample of networks that have launched service and gained distribution.[184] The data also account for the impact of DBS competition on the carriage decisions of cable operators. For example, any competitive pressure from DBS that makes a cable operator's refusal to carry a particular programming network more costly will be reflected in an increase in the odds of network survival. The study also accounts for the effect of vertical integration with a cable operator on the viability of a network and the value of being associated with a successful network (a "spin-off").[185] Because the study evaluates the viability of a network over its lifecycle beginning with its inception, it is able to account for the relatively small number of subscribers a network requires to remain viable in its early stages, while accounting for the larger number of subscribers necessary at later stages.[186]

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[182] Keith Brown, *How many viewers does a cable network need? A survival analysis of cable networks*, 39 APPLIED ECON. 2581 ("*Network Survival Study*"). The study is based on the same data and method as a Media Bureau Staff Research Paper (Keith S. Brown, *A Survival Analysis of Cable Networks*, Media Bureau Staff Research Paper No. 2004-1 ("*Media Bureau Survival Study*") (rel. Dec. 7, 2004)).

[183] *2005 Second Further Notice*, 20 FCC Rcd at 9420 ¶ 84.

[184] Erdem, Katz and Morgan claim that the sample is biased because it is based on financially successful networks. Comcast March 16, 2007 Further Supp. Comments, Erdem, Katz, and Morgan Decl. at 36. However, the sample includes successful as well as unsuccessful networks and therefore is not biased. In fact, it is not possible to estimate a survival model if the sample only includes successful networks. Of the networks in the sample, 31.5 percent were unsuccessful in the sense that they exited the market during the sample period. *See infra* ¶ 56. The author of the study attempted to obtain data on all networks that were in existence during the sample period. While it is possible that the author did not obtain data on all networks, we are confident that the majority of existing networks are in the sample. Furthermore, the *Media Bureau Survival Study* lists all of the networks in the sample, and Comcast has failed to identify any "unsuccessful" networks that should have been included in the sample but were not.

[185] *Network Survival Study*, Table 2.

[186] Erdem, Katz and Morgan claim that the study is not based on any underlying economic theory that would provide a foundation for the estimation method. Comcast March 16, 2007 Further Supp. Comments, Erdem, Katz, and Morgan Decl. at 36. However, economic theory examining the effect of uncertainty in a dynamic context on firm decisions, a well-developed area of economics, indicates that longitudinal studies such as the *Network Survival Study* that can incorporate state dependence are more appropriate tools than those that do not. State dependence occurs when current actions are affected by past decisions and conditions, even after controlling for the explanatory variables used in the model to describe current conditions. Jeffrey D. Wooldridge, *Econometric Analysis of Cross Section and Panel Data* (MIT Press 2002). For example, Jovanovic illustrates the importance of the need to account for the history of firms when examining exit. Boyan Jovanovic, *Selection and the Evolution of Industry*, 50 ECONOMETRICA 649-70 (1982). Dixit also uses dynamic optimization to develop a model explaining exit decisions of firms. Avinash Dixit, *Entry and Exit Decisions under Uncertainty*, 97 J. OF POL. ECON. 620-38 (1989). In these models, and their many derivatives over the intervening years, the cause of firm exit is unpredictable fluctuations in cost, demand, or other parameters. *See also* David B. Audretsch and Talat Mahmood, *The rate of hazard confronting new firms and plants in U.S. manufacturing*, 9 REV. OF INDUS. ORG. 41-56 (1994); Rajshree Agarwal and Michael Gort, *The Evolution of Markets and Entry, Exit and Survival of Firms*, 78 REV. OF ECON. AND STAT. 489-98 (1996); Dietmar Harhoff, Konrad Stahl and Michaerl Woywode, *Legal Form, Growth and Exit of West German Firms - Empirical Results for Manufacturing, Construction, Trade and Service Industries*, 46 J. OF INDUS.

(continued….)

53. We reject Erdem, Katz, and Morgan's allegation that the study failed to address network heterogeneity and account for the endogeneity of network decisions on cost and quality.[187] This is a curious position since the *Media Bureau Survival Study* discusses and estimates models that account for these issues.[188] Unfortunately, there is not a statistical model that will address both issues simultaneously. It is necessary to choose the lesser of two evils. In the end, we have chosen to rely on the model that does not require strict exogeneity. We do so because one of the common causes of endogeneity is a failure to control for unobserved characteristics that influence the probability of survival.[189] We believe that relaxing the assumption on strict exogeneity is more appropriate than using the model that requires strict exogeneity. Furthermore, we note that the peer-reviewed *Network Survival Study* on which we base our calculations reports results only for the model that eases the assumption on strict exogeneity.

54. We also reject Erdem, Katz, and Morgan's contention that the study is flawed because it does not explicitly model the source of dynamics and state dependence.[190] The Commission's reasoning behind the ownership limit is to ensure that the actions of a single cable operator cannot unilaterally eliminate a network. Erdem, Katz, and Morgan's suggestion that larger cable operators could ensure that new networks grow more quickly is true only for those networks that the large cable operator chooses to carry. However, it does not address our concern that the largest cable operator would be able to effectively dictate which networks will be carried by all operators due to its ability to eliminate the viability of networks that it does not carry. The source of the state dependence is very clear. For an average cable network to be successful, it must reach a certain number of subscribers. While there may be other means to meet Congress' goal regarding the flow of video programming, the statute directs us to use a limit on the size of a cable operator to accomplish the goal. Our limit is designed to ensure that a large cable operator cannot unilaterally condemn a cable network by refusing carriage.

55. In order to use the *Network Survival Study* to estimate the minimum viable scale of a programming network, it is necessary to choose the point in the network's life at which to measure viability, as well as the probability that the network survives past that point. We consider five years from the launch of a network to be an appropriate point for measuring viability. In the course of its first five years, a network will have an opportunity to market itself to MVPDs, as well as to attract the attention of consumers, advertisers, the investment community, and the popular press.[191] On the other hand, we believe that measuring viability at a later time (e.g., ten years) may be excessive. We have attempted to choose a viability date that is beyond the "start-up" phase and permits a programmer to establish itself, but not so long that it attempts to ensure success for an extended period.

(Continued from previous page)
ECON. 453-88 (1998); Jose Mata and Pedro Portugal, *The survival of new domestic and foreign-owned firms*, 23 STRAT. MGMT. J. 323-43 (2002). The estimation strategy is designed to model these fluctuations without assigning an underlying cause to each fluctuation. In fact, we think it is impractical to obtain the precise reason that each network failed and incorporate it into an empirical model. The model we have chosen acknowledges the basic reality that if a network has sufficient subscribers to generate revenue to cover its costs, failure is much less likely.

[187] *See supra* note 186.

[188] *Media Bureau Survival Study*, Table 2.

[189] Jeffrey Wooldridge, *Econometric Analysis of Cross Section and Panel Data*, MIT Press, 2002, p. 50-51.

[190] Comcast March 16, 2007 Further Supp. Comments, Erdem, Katz, and Morgan Decl. at 36-37. As noted above, state dependence occurs when current actions are affected by past decisions and conditions, even after controlling for the explanatory variables used in the model to describe current conditions. *See supra* note 186.

[191] This is consistent with TAC's claim that the success of programming networks is generally evaluated over a five-to-seven-year time horizon. TAC Comments to the *2005 Second Further Notice* at 16.

56. Next, we must select an appropriate probability of survival.[192] The *Network Survival* study calculates minimum viable scale at survival probabilities of 50 percent, 70 percent, and 90 percent. We choose to base our limit on the average survival rate of a programming network observed in the industry.[193] According to the *Network Survival Study*, from 1984-2001 the failure rate among the 305 networks in the sample was 31.5 percent,[194] indicating that 68.5 percent of networks in the sample survived. Thus, we choose a survival probability of 70 percent at the five year mark as this is the closest of the three choices we calculated to the number we observed in the study. In other words, we find that the minimum viable scale is represented by the number of subscribers a network needs to serve after five years in the market to have a 70 percent probability of survival.

57. We also need to decide which characteristics of a network should be taken into account when calculating the survival probability. We use the survival probability for a network that is not vertically integrated and is not a "spin-off" of an existing network. We exclude the effect of vertical integration and "spin-offs" from the calculation in order to account for the additional difficulties faced by independent and unaffiliated programming networks. Thus, we rely on empirical data indicating the number of subscribers needed for a network with the characteristics specified above to have a 70 percent probability of survival after five years. These choices lead to a minimum viable scale of 19.03 million subscribers.[195]

3. Subscriber Penetration Rate

58. In 1999, the Commission estimated that the typical programming network had only a 50 percent chance of actually serving all available "open field" MVPD subscribers, based on lack of channel capacity on cable systems, penetration of digital tiers, and other factors.[196] Today, that 50 percent chance is much lower as a consequence of the proliferation of digital tiers on which new programming networks are typically placed. When the impact of this digital tier placement is factored in with the number of MSOs a network is able to reach, and the limited number of systems under each of those MSOs in which they are given carriage rights, the result is a significantly lower penetration rate. In the present Order, we calculate more precisely the percentage of subscribers a programming network will serve.

59. Several commenters dispute the Commission's prior assumption that cable networks are available to only 50 percent of the subscribers to the MVPD on which they are carried, an assumption the Commission relied upon in determining that programmers need an open field equal to 40 percent of all MVPD subscribers.[197] AT&T contends that a number of programming networks are viewed by more

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[192] To derive estimates of programmers' subscribership requirements, the *Network Survival Study* uses a survival/duration model that estimates a programming network's probability of exit from the marketplace based on different characteristics, including the network's subscribership at specific points in time.

[193] We chose a minimum viable scale and penetration rate that reflect the average cable network. Our calculations provide a minimal amount of protection to average networks. Networks that choose high-cost strategies that require a large number of subscribers to remain viable will not be protected under this ownership limit, contrary to the allegations of Erdem, Katz and Morgan. Comcast March 16, 2007 Further Supp. Comments, Erdem, Katz, and Morgan Decl. at 33; see *supra* note 49. Furthermore, even these networks are protected only for the first five years of their existence. After those five years, the ownership limit will not provide them with a safe harbor in which they can survive without carriage by the largest MSO.

[194] That is, of all the networks in the sample at any time, 31.5 percent of them exited the market at some point. *Network Survival Study* at 18, Table 1.

[195] *Network Survival Study* at 10 and Table 4 at 22. This figure will be inserted in the formula above for the variable "MVS."

[196] *1999 Cable Ownership Order*, 14 FCC Rcd at 19114-18 ¶¶ 40-50.

[197] AT&T Comments to the *2001 Further Notice* at 65-66; Time Warner Comments to the *2001 Further Notice* at 26-28; Time Warner Reply Comments to the *2001 Further Notice* at 18.

than 50 percent of all MVPD subscribers.[198] AT&T also contends that competition in the MVPD market has grown rapidly, which gives all cable operators strong incentives to secure carriage rights for new programming that has received favorable consumer response.[199] Additionally, AT&T asserts that increased channel capacity resulting from the deployment of digital technology has greatly expanded cable and non-cable outlets for programming and increased the demand for programming by cable operators and other program purchasers and distributors.[200] On the other hand, cable operators have complained about capacity constraints because of the increased capacity demands of digital television, including high definition television, and their need to increase the speed of data services they provide.[201] Time Warner maintains that the Commission's reliance on average penetration numbers for all national video programming services was misplaced because these subscribership numbers are not a valid proxy for entrants' probability of carriage success.[202] Comcast argues that the Commission must clarify the meaning of the success rate assumption before the Commission can rely on it.[203] It further argues that the fact that a network is denied carriage does not mean it was denied unfairly, and that the market factors used to set the success rate do not have any relevance to whether cable operators are acting in an "unfair" manner.[204] It complains that the data used to establish the 50 percent rate was flawed and out of date, and that the use of current data would yield a much higher rate.[205]

60. We agree with commenters who contend that we must take into account tier placement and other carriage arrangements when determining the open field necessary to ensure that the decision of a single cable operator does not cause a network to exit the market. Accordingly, we take into account tier placement in our current analysis, and recognize that many, if not most, new cable networks are placed on a digital tier. A consequence of being placed on a digital tier versus one of the basic levels of service with the greatest penetration rates is a much lower penetration rate. Previously the Commission relied on a general 50 percent penetration rate for a new programming network that was based on an analysis which ignored the increased difficulties of recently launched networks in obtaining distribution. Instead,

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[198] *See* AT&T Comments to *the 2001 Further Notice* at 65; *see also* Time Warner Comments to the *2001 Further Notice* at 26.

[199] AT&T Comments to the *2001 Further Notice* at 65

[200] *Id.* at 66.

[201] *See, e.g.,* NCTA Comments in Docket No. 98-120 (June 14, 2006) at 7-8, available at http://gullfoss2.fcc.gov/prod/ecfs/retrieve.cgi?native_or_pdf=pdf&id_document=6518359837 (stating that cable operators have to choose among the content offered by broadcasters because of the "scarce available capacity;" the competitive marketplace in which cable does business requires that operators use their capacity to promote services, particularly in light of their decreasing market share); NCTA Comments in Docket No. 98-120 (June 12, 2006), available at http://gullfoss2.fcc.gov/prod/ecfs/retrieve.cgi?native_or_pdf=pdf&id_document=6518359613 (stating that full carriage of digital signals would interfere with the ability of independent programmers to compete for carriage on cable systems.); NCTA Comments in Docket No. 98-120 (June 8, 2006) at 2, 6, available at http://gullfoss2.fcc.gov/prod/ecfs/retrieve.cgi?native_or_pdf=pdf&id_document=6518359266 (stating that full carriage of digital broadcast signals consumes cable capacity that would otherwise be available for other consumer services); *Ex Parte* Letter from Willkie, Farr and Gallagher, LLP on behalf of Comcast (Nov. 15, 2004) at 2, available at http://gullfoss2.fcc.gov/prod/ecfs/retrieve.cgi?native_or_pdf=pdf&id_document=6516882143 (stating that full carriage of digital signals would interfere with the ability of Comcast to offer additional services, such as VOIP).

[202] Time Warner Comments to the *2001 Further Notice* at 27 (arguing that low penetration rates in certain instances were due to poor marketing, unappealing content, and recent market entrance).

[203] Comcast June 8, 2007 Further Supp. Comments at 3, 5-8.

[204] *Id*. at 11-15.

[205] *Id*. at 15-19.

the Commission calculated a value based on the penetration of a limited sample of successful networks.[206] Because our minimum viable scale estimate is based on the survival probability of a network five years after launch, our present analysis focuses on the subscriber penetration that a network is likely to achieve in that time frame.

61. For this purpose, we use data from the Commission's Cable Price Survey to estimate the likely penetration of a programming network given its age.[207] Thus, our new calculation is based on empirical study of system carriage and tier placement of networks. The Cable Price Survey sampled 783 cable community units as of January 1, 2006. For each franchise, the respondent provides a list of the programming networks that are carried, the tier on which each network is carried, and the number of subscribers to the tier. By aggregating all of this information to the level of an MSO, we calculate the fraction of each MSO's subscribers who have access to a specific programming network.[208] We then calculate a weighted average of the MSO-specific penetration rates using the size of the MSO as the weight. In this manner we construct an estimate of the fraction of MSO subscribers that have access to the specific programming network on those MSOs that carry the network.[209] The number of years since the launch of each of the networks is also calculated.[210] With this information it is possible to predict the fraction of an MSO's subscribers a programming network is likely to have access to at any point in its lifecycle. Due to the small number of programming networks in any single age category, we use linear regression to develop a more robust estimate of the relationship between the subscriber penetration rate and the age of a network. As described in the technical appendix, ordinary least squares estimation yields:

$$Pen = 0.0489 + 0.0493 \cdot Age - 0.0008 \cdot Age^2$$

The regression predicts that five years after launch a network will be available to 27.42 percent of the subscribers of the MSOs that carry the network.[211] Thus, 0.2742 will appear in the formula above in place of the variable for penetration rate, "Pen"[212]

62. We note that this calculation represents an average value for penetration after five years. Alternatively, we could have chosen a value that reflects the typical penetration rate of either smaller or larger networks. As the Commission previously has noted, some networks can survive with greater or

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[206] *1999 Cable Ownership Order*, 14 FCC Rcd at 19117 ¶ 49.

[207] This data is drawn from the Cable Price Survey as of January 1, 2006.

[208] We base our calculation on the responses of Comcast, Time Warner, Cox, Charter, Adelphia, Cablevision, BrightHouse, Mediacom, Insight, Cable One, RCN, BellSouth, Knology, WideOpenWest, and WEHCO. These firms comprise approximately 90 percent of cable subscribers. We are unable to account for DBS in this calculation because we do not have information on the number of subscribers to the various tiers of service sold by each DBS operator.

[209] We exclude premium networks such as HBO and Showtime as well as high-definition and foreign language networks. Premium networks operate on a significantly different economic footing than other networks since they are sold individually to consumers. We exclude high-definition networks because this market remains in early growth phases and does not provide sufficient long-term data to develop estimates. Foreign language networks are excluded since in many cases the fixed costs of program production are recovered in the home countries of the networks and therefore the need to recover fixed costs from U.S. distribution is lessened. Our estimation procedure uses data on 135 programming networks.

[210] *12th Annual Video Competition Report*, 21 FCC Rcd at 2622-43, Tables C-1 and C-2.

[211] Due to rounding, the listed regression coefficients do not generate exactly 27.42 percent, which is calculated using the full precision of the regression coefficients.

[212] *See supra* ¶ 40.

fewer subscribers than the average.[213] Our direction under the statute, however, is to protect the flow of programming to consumers, while taking account of the efficiencies and benefits that may result from increased ownership. If we selected a penetration rate more suitable for networks that can survive with fewer subscribers, our calculations would result in a higher limit. Such a limit, though, would allow the largest MSO to impede the flow of programming from networks that require an average amount of subscribers or more to survive, in contravention of our statutory mandate. Reliance on the penetration rate for more widely distributed networks, on the other hand, would produce a lower horizontal limit potentially maximizing the flow of programming to consumers, but also denying consumers the benefits that result from economies of scale that cable operators can achieve through growth. Choosing an average network penetration rate balances these two concerns and thus fulfills our mandate most effectively.

4. Accounting for Coordinated Action

63. In 1999, the Commission implicitly used a coordination index of two because it was concerned that two cable operators could jointly refuse to carry a programming network and therefore prevent the network from becoming viable. The court rejected the Commission's analysis and held that the Commission must present empirical or theoretical evidence that coordinated action is likely in order to sustain a limit based on a theory of joint action.

64. TAC asserts that the behavior of the two largest cable operators, Comcast and Time Warner, is indicative of joint action. It contends that if one of the two cable operators agrees to carry a programming network, the other is likely to carry it as well. In addition, TAC contends that if one of the operators denies carriage, the other is very likely to deny carriage as well.[214] CFA claims that "[t]he Court's standard, which requires the Commission to demonstrate the virtual certainty of collusion in analyzing the impact of two cable operators' refusal to grant carriage, fails to recognize that when a small number of firms are present in an industry, parallel actions accomplish virtually all of the anticompetitive harm of collusive activity."[215] Consequently, they propose that the Commission should assume that the two largest firms engage in some level of coordination. Kang provides evidence that vertically integrated cable operators are more likely to carry the recently launched programming networks of other vertically integrated cable operators than are non-integrated cable operators. He states that this is evidence that a group of cable operators might collectively deny carriage to a start-up programming network.[216] Ordover and Higgins suggest that Kang's results may be evidence that non-integrated cable operators favor non-integrated programming networks rather than evidence of discrimination on the part of integrated cable operators.[217] Erdem, Katz and Morgan argue that Kang's study suffered from severe sample selection bias and that his study fails to distinguish between large MSOs and all owners of multiple cable networks. They also contend that Kang's conclusion that vertically integrated cable operators are likely to collude, causing harm to consumers and reduced entry by new networks, does not necessarily follow

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[213] *2001 Further Notice*, 16 FCC Rcd at 17323 ¶ 13.

[214] TAC Comments to the *2005 Second Further Notice* at 29.

[215] CFA asserts that the Commission should continue to use the open field approach, and account for both Comcast and Time Warner in its analysis, not just the top firm as it has in the past. CFA maintains that the Commission should include Comcast and Time Warner in its open field analysis because "[n]o current programmer denied carriage by either of the top two firms has come close to achieving the necessary reach to attract advertising on the scale that is widely recognized as the threshold for long term survival of national programming." CFA Comments to the *2005 Second Further Notice* at 15-17.

[216] Jun-Seok Kang, *Reciprocal Carriage of Vertically Integrated Cable Networks: An Empirical Study* at 21.

[217] Comcast Reply Comments to the *2005 Second Further Notice*, Ordover & Higgins Decl. at 11-12.

from the observed pattern of carriage his study purports to detect.[218]

65. Other commenters state that the Commission's theory of collusion is flawed. AT&T asserts that the Commission's collusion theory is "entirely conjectural" and cannot stand without substantial evidence showing the existence or likelihood of unilateral or collusive anticompetitive actions by MSOs.[219] In particular, AT&T asserts that cable operators have not disfavored unaffiliated programmers or unfairly favored affiliated programmers in their carriage decisions.[220] Comcast finds a lack of evidence that collusion is "likely" and criticizes the Commission for not addressing (1) how or why participants in an allegedly collusive refusal to deal would reach an agreement to refuse to deal in the first place, (2) the extent to which they would have an incentive to deviate from such agreement, (3) whether participants could punish a firm for deviating, and (4) the role of maverick firms in preventing coordinated interaction.[221] NCTA emphasizes that the court rejected the Commission's open field approach because the Commission lacked evidence that the top two cable operators are likely to collude.[222] Reiterating its comments filed in response to the *2001 Further Notice*, NCTA states that beyond the lack of evidence of actual collusion, there is "no reason to believe that MSOs have any incentive to engage in such activity."[223]

66. Accordingly, we do not include an adjustment for coordinated action. While commenters have provided some evidence that large cable operators tend to carry the same programming networks, they have not provided a sufficient set of arguments to demonstrate that it is coordinated action rather than individual action generating the observations. It is not surprising, for example, that nearly every cable MSO carries the most popular networks. Such an observation likely arises from the popularity of the network, not necessarily from collusive action. Thus, we lack evidence to draw definitive conclusions regarding the likelihood that cable operators will behave in a coordinated fashion.

5. The Cable Horizontal Ownership Limit

67. After careful consideration of the evidence before us, including the language and intent of the statute and our understanding of the programming market, we determine that use of the open field approach to set a horizontal limit is the most appropriate means of ensuring that the flow of programming to consumers is not unfairly impeded. The modified open field method that we adopt in this *Order* yields a horizontal ownership cap that ensures that no cable provider is so large that it can prevent a programmer from serving "the number of viewers needed for viability – independent of concerns over anticompetitive conduct."[224] We apply the first three values discussed above to the ownership limit formula, and reject the fourth value concerning coordinated action. The values we apply are (1) a total

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[218] Comcast March 16, 2007 Further Supp. Comments, Erdem, Katz, and Morgan Decl. at 44-45.

[219] AT&T Comments to the *2001 Further Notice* at 67-68

[220] *Id.*

[221] Comcast Comments to the *2005 Second Further Notice* at 75. Comcast Supp. Comments at 12-14. Comcast Further Supp. Comments at 11. Comcast March 16, 2007 Further Supp. Comments, Erdem, Katz, and Morgan Decl. at 38-43.

[222] NCTA Comments to the *2005 Second Further Notice* at 13-14.

[223] *Id.* at 13-14 (quoting NCTA Comments to the *2001 Further Notice* at 19 (arguing that cable operators' incentives to collude to deny carriage to a programming network or to artificially suppress the price or quality of programming are constrained by the same changed marketplace conditions that make unilateral anticompetitive activity unlikely)). NCTA also claimed in its comments in response to the *Second Further Notice* that the open field approach is too difficult to apply empirically because there is not a single "critical mass" of households that a programmer must achieve to be viable. *Id*. at 14.

[224] *Time Warner* II, 240 F.3d at 1131-32.

MVPD subscriber number of 95,784,478;[225] (2) a minimum viable scale of 19,030,000;[226] and (3) a subscriber penetration rate of 0.2742.[227] The calculation generates a result of .28, which reflects that as long as the largest cable operator does not serve more than 28 percent of all MVPD subscribers, that operator cannot significantly undermine the viability of a programming network by refusing to carry the network.[228]

68. Based on this calculation, we conclude that a horizontal limit of 30 percent will best serve the public interest. As noted above, the Commission first established a 30 percent horizontal ownership limit in 1993.[229] In 1999, the Commission revised the method by which horizontal ownership was calculated, but retained a 30 percent ownership limit.[230] Although that limit was subsequently remanded by the court, the Commission has continued to apply the 30 percent limit in merger reviews since that time and the media marketplace has continued to operate under this requirement. Therefore, for consistency, we adjust the limit slightly upward, from 28 percent to 30 percent. This small upward adjustment is unlikely to cause harm. We do not believe this minor adjustment will adversely affect our ability to provide the protection the statute requires. Moreover, this adjustment will have no affect on the largest cable operator in the market today because it would satisfy either a 28 percent or 30 percent limit.[231] For these reasons, we set a 30 percent horizontal limit.

69. In setting the 30 percent limit, we must, as instructed by the *Time Warner II* court, assess "the determinants of market power in the cable industry" and draw "a connection between market power and the limit set."[232] Comcast argues that the Commission should account for MVPD competition by excluding for the purposes of determining compliance with the ownership limit all of an MSO's cable subscribers in areas where the Commission has granted effective competition petitions.[233] Admittedly, the focus of our open field analysis is on cable operators' influence and impact on the upstream programming market, not on their economic position in the downstream MVPD market. We recognize that competition in the downstream market may affect the ability of a large cable operator to prevent successful entry by a programming network, and that our open field analysis does not directly measure this. For example, it is possible that a large cable operator may be pressured by competition in the MVPD market, principally from DBS, into carrying reasonably popular networks within the five-year timeframe contemplated in our probability survival analysis, thus leaving a large operator unable to "unfairly impede" the success of that network.[234] Alternatively, however, a cable operator controlling

[225] *See supra* ¶ 43.

[226] *See supra* ¶ 57.

[227] *See supra* ¶ 61

[228] 1- (19,030,000 / (0.2742 x 95,784,478)) = 0.28.

[229] *See 1993 Second Report and Order,* 8 FCC Rcd at 8567, ¶ 3.

[230] *See 1999 Cable Ownership Order,* 14 FCC Rcd at 19101, ¶ 6.

[231] Letter from Peter H. Feinberg, Assoc. General Counsel for Comcast Corp., to Marlene H. Dortch, Secretary, FCC (Sept. 24, 2007) at 1-2. In its latest filing, Comcast states that it reaches 27.1 percent of U.S. MVPD subs. Comcast uses a figure of 95.7 million for total MVPD subscribers, based on an August 2006 Kagan report. http://fccweb01w.fcc.gov/prod/ecfs/retrieve.cgi?native_or_ df=pdf&id_ document =6518508506.

[232] *Time Warner II*, 240 F.3d at 1133-34.

[233] Comcast Supp. Comments at 27-28.

[234] The modified open field approach, however, appropriately accounts for the effects of competition from DBS providers in one important respect. Because of the inclusion of DBS subscribers in the calculation of the size of the MVPD market, continued growth of DBS subscribers will increase the size of the open field available to a network, which will be reflected in our calculations by a reduction of cable operators' share of the MVPD market. This effect (continued….)

more than 30 percent of the MVPD market may be able to significantly undermine the viability of a reasonably popular programming network by indefinitely refusing to carry it, notwithstanding that network's level of popularity and carriage by DBS competitors. We note that measuring cable operators' downstream market power, and determining its impact on the flow of programming in the upstream retail market, is quite difficult, and that no commenter has provided a reliable and appropriate theoretical framework or empirical data by which to do so.[235] Thus, we are forced to make a determination concerning whether competition in the retail MVPD market negates the importance of having a sufficiently open field and, without the benefit of definitive evidence, we conclude for the reasons detailed below that it does not.

70. Most importantly, we do not believe that a single new programming network, having failed to gain carriage on the largest cable operator's system, would have a good chance of both gaining carriage on other MVPDs and then induce enough of the large cable operator's subscribers to switch to the other MVPDs either to allow the network to gain sufficient subscribership to be financially viable, or to place substantial pressure on the large cable operator to carry the network within a reasonable period of time. Specifically, we find that the shift of subscribers would be unlikely to be significant or sufficient to permit entry for several reasons. First, due to switching costs, consumers are reluctant to switch MVPDs except when there is a large benefit.[236] Second, cable operators reduce the likelihood of switching by offering non-video services (e.g., broadband Internet access and phone service), giving the cable operator some market power in video service.[237] Third, consumers are unlikely to switch providers to gain access to new programming because video programming is a product, the quality of which cannot be known with certainty until it is consumed. It is difficult for consumers to know whether they would

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is real, not hypothetical. From 2001 through 2005, the number of MVPD subscribers increased by 8.16 million, but the number of cable subscribers *decreased* by 1.3 million, and cable's share of MVPD subscribers declined from 77.54 percent to 69.41 percent. During the same period, DBS providers added 10 million subscribers, and their share of MVPD subscribers increased from 18.67 percent to 27.72 percent. *See 2005 Video Competition Report*, Table B-1.

[235] There is no simple rule concerning the relationship between the level of competition in the downstream market and the likelihood of foreclosure in the upstream market. It is possible for the downstream market to be a perfect monopoly while the upstream market is perfectly competitive, if many firms that are monopolists in their local market compete with each other for inputs in the upstream market. It is also possible for the downstream market to be perfectly competitive, while each firm has a perfect monopsony in the upstream market.

[236] *See* Andrew Wise & Kiran Duwadi, "*Competition between Cable Television and Direct Broadcast Satellite – It's More Complicated than You Think*," FCC Working Paper, Jan. 2005, at 21("Wise & Duwadi"). For example, DBS providers typically require customers to agree to one year service commitments to receive subsidized equipment and installation. Customers that do not meet credit criteria may be required to purchase equipment. DirecTV requires customers who do not have a sufficiently high credit score to pay an upfront fee of $200 to $300 that is paid back to them in the form of credits each month they remain subscribers. These subscribers receive their full upfront fee back in $5 increments over 40 to 60 months. *Satellite Business News Fax Update*, Mar. 7, 2007 at 2. These costs are not insignificant and will limit the number of subscribers willing to switch MVPDs. Moreover, we note that some cable subscribers are unable to switch to DBS because it requires a sufficient view of the southern sky in order to aim the receiving dish at the DBS satellites. In northern latitudes, as well as highly urbanized or forested locations, it may not be possible to receive a DBS signal because of these line of sight issues. Residents on the north side of large buildings with multiple dwelling units may also be unable to receive a DBS signal. For an explanation of various signal interference issues, *see* http://www.dishnetwork.com/content/faq/general_information/index.shtml.

[237] Wise & Duwadi at 21; *Adelphia Order*, 21 FCC Rcd at 8286 ¶¶ 186-87. *See also 2005 Video Competition Report* at ¶ 72 (noting that DBS providers' penetration rate was 36 percent in areas where cable operators did not offer advanced services such as digital cable, cable modem service, or telephone service, but only 16 percent in areas where cable operators offered some but not all of those advanced services, and only 14 percent where cable operators offered all three).

enjoy viewing a network which they have never seen before. While consumers can and do switch MVPDs in response to the loss of a program network with which they are familiar, they are unlikely to respond similarly for a program network that distributes content that they have never viewed.[238] Consequently, DBS provides very little competitive pressure when it comes to carriage of new program networks.[239]

71. In addition, without an open field that is large enough, many new programming networks might not even attempt to enter the market without a contract from the largest cable operator. If entering programming networks are unable to sign contracts with MVPDs that have enough subscribers to ensure reasonable prospects for survival, they may be unable to secure financing.[240] Competitive pressures from DBS will not provide any assistance to networks that do not launch due to a lack of financing. In addition, smaller MVPDs may not want to carry networks that lack access to a sufficient number of subscribers to ensure a reasonable chance for survival because of the problems associated with carrying a weak network that eventually disappears (e.g., consumer dissatisfaction with changing channel lineups or other issues relating to obtaining substitute programming).[241] If we allowed the largest cable operator to become so large that the open field is insufficient to permit a new programming network to enter the market with a reasonable probability of survival without gaining carriage on the largest cable operator, then competing MVPDs might not even have the opportunity to carry the network because it will not enter the market at all, thus impeding the flow of new programming to consumers.[242] We therefore cannot rely on competitive pressures to ensure the flow of programming if there is not a sufficiently large open field for entry, because a large cable operator may not be aware, or may not care, that its choices have prevented entry by a cable network that would have become popular.[243]

72. For all of these reasons, we think that it is quite likely that a large cable operator controlling more than 30 percent of the MVPD market would have the power to significantly undermine

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[238] Even in instances where the program network may be highly valued by consumers, a cable operator may refuse carriage for unspecified reasons. For example, Comcast did not carry the regional sports network MASN in the Washington D.C. area, despite the strong value consumers place on the programming of regional sports networks, and apparently with little harm to its subscribership count. *Adelphia Order*, 21 FCC Rcd at 8286 at ¶¶ 186-87.

[239] Our *Cable Price Report* demonstrates the lack of aggressive substitution between cable and DBS. In the large number of communities in which there has been a finding that the statutory test for effective competition has been met due to the presence of DBS service, competition does not appear to be restraining price as it does in the small number of communities with a second cable operator. *Report on Cable Industry Prices* at ¶ 14 (Dec. 27, 2006).

[240] TAC Comments to the *2005 Second Further Notice* at 26 (citing *How Come Vultures Don't Flock to Cable*, CABLEWORLD, Apr. 5, 2005.

[241] The America Channel indicates that investors are reluctant to provide financing, and MVPDs are reluctant to provide carriage, for a new network whose survivability is uncertain. For investors and MVPDs, a new network's likelihood of survival is indicated by the network's ability to obtain contracts for carriage with the largest MVPDs. Thus a new network that fails to obtain carriage with the largest MVPDs will find it difficult to even enter the market, because it will be unable to obtain the financing and carriage necessary to begin operations. TAC Comments to the *2005 Second Further Notice* at 15-17, 22-23, 25-27, 31-32.

[242] The open field approach, in fact, ensures that the downstream MVPD market provides effective competition to the incumbent cable operator, because it ensures that a popular programming network that fails to secure distribution by the incumbent cable operator will have sufficient subscribership to enter the marketplace viably and make itself available to competing MVPDs. Without an adequate open field, a programming network's failure to secure distribution by the largest cable operator may prevent the network from entering the market, thus denying consumers the ability to receive desired programming from any MVPD.

[243] A cable operator will not learn of its mistake, or find out the cost of not carrying the network, unless there is a sufficiently large open field for the network to gain carriage and demonstrate its popularity with other MVPDs.

the viability of a reasonably popular programming network by refusing to carry it, despite the presence of competitive pressures from DBS and other competing MVPDs. Moreover, evidence submitted by The America Channel illustrates the importance of large cable operators in reaching the minimum viable scale. It shows that of the 92 non-premium nationally–distributed networks with more than 20 million subscribers, only one network, INSP – Inspiration Network, was able to reach that scale without receiving carriage from the largest cable operator.[244] Also evident is the importance of the second largest cable operator, Time Warner. Only two networks were able to reach 20 million subscribers without carriage by Time Warner,[245] and no networks reach that scale without carriage by at least one of these large operators. This demonstrates the sensitivity of network survival to the size of the largest cable operator. Very few networks can reach minimum viable scale without carriage on a large MVPD. The record indicates that no networks with more than 24 million subscribers have been able to do so without carriage by both of the largest cable operators.[246]

73. Finally, to the extent that there is an inherent lack of certainty as to the operation of the MVPD market for these purposes, we believe that the statute provides guidance as to how we should weigh the relevant risks in formulating our regulations. In particular, while the statute compels the Commission to "take particular account" of the market structure, "including the nature and market power of the local franchise," it also requires us to "*ensure* that no cable operator . . . can unfairly impede . . . the flow of video programming from the video programmer to the consumer."[247] Thus, although some uncertainty exists, we believe that our priority should be to make sure that a single cable operator may not significantly undermine the viability of programming network, and we do so here by establishing a 30 percent limit.

D. Relevant Geographic Market

74. In 2005, the Commission tentatively concluded that the relevant market for purposes of setting the horizontal ownership limit under the Section 613(f) is no greater than the United States.[248] In other words, the Commission tentatively concluded that the international market is not relevant to the establishment of the horizontal limit. We now affirm that tentative conclusion.

75. Very few commenters address the relevant geographic market. Comcast disagrees with the Commission's tentative conclusion to ignore the international distribution market, given what it characterizes as the increasing importance of the market to the health and vitality of programmers. Comcast states that the global marketplace offers program providers with significant alternative outlets for content. It claims that media companies have a strong presence in overseas markets and that many media companies view international sales as critical to their profit margins. As an example, Comcast states that in 2004, 22 percent of Disney's $30.8 billion in revenue and 35 percent of the company's $4.5 billion in operating profit came from the international market.[249]

76. We find it reasonable to concentrate our inquiry on the effects of cable concentration in the United States. The Commission has concluded in the past that the programming market is at least national.[250] No commenter has presented economic data that define the contours of the programming

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[244] TAC Comments to the *2005 Second Further Notice*, Exh. 2 at 56-58.

[245] According to TAC, these two networks are TV One and The NFL Network. *Id*. at 58.

[246] Id. at 56-58.

[247] 47 U.S.C. § 533(f)(2)(A), (C) (emphasis added).

[248] *2005 Second Further Notice*, 20 FCC Rcd at 9413 ¶ 70.

[249] Comcast Comments to the *2005 Second Further Notice* at 47.

[250] *See AT&T-Comcast Order,* 17 FCC Rcd at 23261 ¶ 43; *Adelphia Order,* 21 FCC Rcd at 8237 ¶ 68.

market. Instead, commenters make the uncontroversial point that United States programmers sell some programming to international buyers and also rely on distribution outlets other than cable or DBS.[251] Accordingly, we limit our inquiry to the national programming market and cable operators' effect on it. Nevertheless, our open field analysis accounts for the effects of international distribution in estimating the minimum viable scale needed for a programmer to achieve viability.

E. Regional Limits

77. The Commission also sought comment on whether and to what extent a regional limit on concentration would better effectuate the statutory mandates set forth in Section 613(f)(2).[252] Very few commenters directly address the issue of regional limits.[253] Instead, a number of commenters discuss the importance of regional concentration to any analysis of market power. Some of these commenters offer proposals for taking regional concentration into account in formulating a horizontal limit, but no commenter proposes specific regional limits or a defined approach for devising them. As explained below, we decline to adopt regional limits.

78. CFA and MAP advocate adoption of regional limits, arguing that market power in the cable industry is expanding and is being reinforced by control and distribution of regional sports programming.[254] In addition, CFA and CWA ask the Commission to go beyond simply counting subscribers, and, instead, to consider the effects of regional clustering, which they claim reinforces cable operators' market power and creates significant barriers to entry.[255] Citing to the *11th Annual Video Competition Report*, CFA points out that DBS penetration is lower in areas where cable operators carry regional sports networks.[256] In addition, CWA states that clustering allows MSOs to attain regional market shares that make them indispensable to local and regional programming networks seeking distribution.[257]

79. CFA also asks the Commission to consider, in both transaction review and its efforts to adopt a horizontal limit, the importance of the top 25 markets, which comprise 49 percent of the national TV households and 59 percent of advertising revenues.[258] Specifically, CFA states that in determining whether a merging firm would exceed the national limit, the numerator (the market share of the merging firm) should be increased by the advertising premium of the top markets.[259] In addition, as discussed above, it states that the Commission should discount the relative weight of DBS by applying a 10 percent discount in the denominator to reflect the advertising-revenue-adjusted weight of satellite subscribers.[260]

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[251] *See, e.g.*, AT&T Broadband Comments to the *2001 Further Notice* at 30; Comcast Comments to the *2005 Second Further Notice* at 45-48; Comcast Comments to the *2001 Further Notice* at 17-20.

[252] *2005 Second Further Notice*, 20 FCC Rcd at 9413 ¶ 70.

[253] *See, e.g.,* AT&T Comments to *2001 Further Notice* at 30-34; Comcast March 16, 2007 Further Supp. Comments at 20-22.

[254] CFA Comments to the *2005 Second Further Notice* at 25-26; MAP Comments to the *2005 Second Further Notice* at 29-35.

[255] CWA Comments to the *2005 Second Further Notice* at 8-10, CFA Comments to the *2005 Second Further Notice* at 54-55.

[256] CFA Comments to the *2005 Second Further Notice* at 53-54.

[257] CWA Comments to the *2005 Second Further Notice* at 8-10.

[258] CFA Comments to the *2005 Second Further Notice* at 55-56.

[259] *Id*.

[260] *Id*. at 58-60, 69.

When these factors are considered, CFA concludes that the horizontal limit should be 20-30 percent.[261]

80. DirecTV maintains that satellite providers are at a competitive disadvantage in the broadcast and regional programming market because clustering has given cable operators a significant advantage due to their large subscriberships within regions. It states that cable operators can withhold or raise prices of "must-have" regional programming from rivals because "the cost of withholding programming from rivals may be outweighed by whatever premium the cable operator is willing to pay for the exclusivity."[262] DirecTV, however, does not advocate regional caps, but instead believes that the Commission's transaction review process should be used to address regional concentration issues.[263] Specifically, DirecTV states that, in transaction review, the Commission can define geographic and product markets more accurately based on the facts of each case.[264] It also states that the Commission should not consider all programming to be of equal value to consumers. For instance, DirecTV asserts that withholding regional sports is more likely to cause subscriber shifts than withholding other types of programming.[265]

81. Comcast claims that it does not impede the flow of programming in regional markets, as evidenced by the increase in the number of regional networks.[266] It notes that since 1998, regional networks have grown from 61 to 96, an increase of 57 percent, and that from 1998 to 2004, regional sports networks have increased from 29 to 38 and news networks have increased from 25 to 40.[267] Comcast claims that clustering benefits subscribers because it enables cable operators to compete with DBS operators, which have "ubiquitous national coverage allowing for cost-effective national advertising campaigns and tie-ins to national retail chains to aggressively market services and promotions."[268] It also states that clustering enables cable operators to compete with incumbent LECs with respect to geographic scope, and it provides examples of the markets where it has launched its competitive digital voice service.[269] Finally, Comcast asserts that clustering stimulates investment and delivery of new local and regional programming services, offering examples of markets in which it has launched cable news networks.[270]

82. The Commission previously considered whether to adopt regional subscriber limits, and declined to do so.[271] In 1993, the Commission stated that other provisions of the 1992 Cable Act were specifically designed to introduce local competition and would better address issues regarding regional concentration.[272] In addition, the Commission observed that there was no evidence in the record

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[261] *Id*. at 68-70.

[262] DirecTV Comments to the *2005 Second Further Notice* at 5.

[263] *Id*. at 6-7

[264] *Id.* at 8.

[265] *Id*. at 8-9. In its reply comments, Comcast notes DirecTV's opposition to regional limits, and claims that if DirecTV and other competitive outlets offer programmers a viable alternative to cable for program distribution, then a cable ownership limit is unnecessary. Comcast Reply Comments to the *2005 Second Further Notice* at 8-10.

[266] Comcast Comments to the *2005 Second Further Notice* at 43-45.

[267] *Id.* at 43-44

[268] *Id*. at 51.

[269] *Id*. at 51-53

[270] *Id*. at 51-53.

[271] *1993 Second Report and Order*, 8 FCC Rcd at 8572-73 ¶ 16; *1999 Cable Report and Order*, 14 FCC Rcd at 19124 ¶ 63.

[272] *1993 Second Report and Order*, 8 FCC Rcd at 8572-73 ¶ 16.

indicating that any anticompetitive effects outweighed the potential benefits of cable clustering, such as regional programming, upgraded cable infrastructure, and improved customer services.[273] In 1999, the Commission found that the record in the proceeding showed that the benefits of clustering – including market efficiencies and the deployment of telephony and Internet access services – outweighed any alleged anti-competitive effects on local programming.[274] We do not have a sufficient evidentiary basis here to reverse the Commission's previous decisions. Instead, we conclude that our case-by-case review of transactions will allow us to identify and prevent any unfair impediments to the flow of programming that may arise from regional concentration.

83. We also decline to adjust systematically the market share of a merging firm by advertising premiums, as suggested by CFA. We do not have definitive evidence in the record that distributors in all of the top 25 DMAs command significant premiums over, for example, the next 25 DMAs. Certainly, in some of the top DMAs, the existence of many outlets for advertising, and competition among them, may serve to reduce advertising rates. Rather than determine a mathematical formula for examining this issue, we will examine all aspects of regional concentration, including the market for advertising and its effect on programmers, when proposed transactions are before us.

F. Application of the Limit

84. In 1999, the Commission revised the prior methodology by counting against a cable operator's horizontal limit only those cable subscribers served by its "incumbent cable franchises," excluding new subscribers gained through overbuilding "non-incumbent cable systems."[275] The Commission also endorsed the use of published, current and widely-cited industry data to establish the number of MVPD subscribers nationwide, for purposes of establishing cable operators' share of the market.[276]

85. CFA challenges the Commission's exclusion of non-incumbent cable franchise subscribers (the overbuild exception) in calculating compliance with the horizontal limit.[277] Additionally, CFA challenges the *1999 Cable Ownership Order's* reliance upon industry data to establish cable operators' share of the MVPD market.[278] As explained below, we reject in part and accept in part CFA's specific challenges to the overbuild exception. Specifically, we find that the exception creates the potential for a cable operator's use of the overbuild exception to reduce the open field below the required 70 percent, and we therefore eliminate it. At the same time, we reject CFA's challenge to the use of industry data for purposes of establishing a cable operator's share of the market to determine compliance with the cap.

1. Exclusion of Overbuild, Non-Incumbent Cable Systems from the Horizontal Limit Calculation

86. We conclude that excluding overbuild subscribers from the numerator in the calculation of a cable operator's market share is fundamentally inconsistent with the open field approach we utilize to calculate the horizontal limit and must be eliminated. The overbuild exception would allow a cable operator near the horizontal limit to use the exception to exceed the 30 percent limit, which would have

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[273] *Id*. at 8573 ¶ 17

[274] *1999 Cable Ownership Order*, 14 FCC Rcd at 19124 ¶ 63.

[275] *See 1999 Cable Ownership Order*, *see also* 47 C.F.R. §§ 76.503(b)-(d)(defining incumbent cable franchise as including all franchises, and all successors in interest to those franchises, that were in existence on October 20, 1999, the date on which the *1999 Cable Ownership Order* was released).

[276] *See 1999 Cable Ownership Order*, 14 FCC Rcd at 19112 ¶ 35.

[277] CFA Comments to the *2001 Further Notice* at 45.

[278] *Id*. at 45-47.

the effect of reducing the open field below the 70 percent that is necessary to ensure that no single operator can, by simply refusing to carry a video network, cause it to fail. Accordingly, we conclude that exclusion of subscribers in overbuild cable franchises should be eliminated.[279]

2. Reliance on Industry Data

87. In addition, CFA faults the *1999 Cable Ownership Order* for allowing cable operators to rely on industry-wide data in determining and reporting their share of the MVPD subscribership market. CFA maintains that because industry reporting services derive information and figures from cable operators and vary in their reported figures, the *1999 Cable Ownership Order's* reliance upon such reported data invites manipulation[280] and forum shopping.[281] Additionally, CFA claims that the *1999 Cable Ownership Order* improperly delegated the government's role in monitoring and regulating the cable industry to private research and reporting services and thereby disallowed public input and scrutiny.[282]

88. In an *ex parte* letter, CFA challenges the Commission's reliance on this standard based on several disclosures of questionable subscriber counts.[283] CFA questions whether third-party publishers are a reliable source of industry data. CFA alleges that these publishers have a disincentive to question the information provided by cable operators because the operators are valued customers who provide a substantial amount of revenue to the publishers for their products and services. CFA contends that even if industry analysts questioned the numbers provided by cable operators, they would have no means to audit the numbers.[284] Further, CFA asserts that MVPDs have incentives to over- or under-report their subscriber figures for various reasons. For example, CFA claims that small cable operators and competitive MVPDs have an incentive to inflate their subscriber numbers to impress Wall Street, which inflates the pool of total MVPD subscribers and reduces the apparent percentage of the largest MVPDs, while the largest MVPDs have an incentive to lower their subscriber counts to avoid the Commission's horizontal ownership limit.[285]

89. CFA recommends that the Commission require all MVPDs to regularly file subscriber counts with the Commission under penalty of sanctions for falsifying information and that the Commission should establish the figure for total MVPD subscribers.[286] CFA further urges the Commission to consider deliberate overcounts provided to private entities or government agencies, such as in statements to the Securities and Exchange Commission, evidence of bad character, such that licensees would jeopardize their licenses by engaging in such activities.[287] NCTA contends that these

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[279] In light of our decision to eliminate the overbuild exception, we need not reach CFA's argument regarding our statutory authority to retain it.

[280] CFA Comments to the *2001 Further Notice* at 45-47.

[281] CFA Feb. 28, 2000 Reply at 6.

[282] CFA Comments to the *2001 Further Notice* at 45-47; CFA Feb. 28, 2000 Reply at 8-10.

[283] CFA cites to DirecTV's counting of subscribers who merely expressed interest in its service and its subsequent revision of its subscriber numbers significantly downward to correct its improperly inflated subscriber count. CFA Oct. 11, 2002 *ex parte* at 3. CFA also cites to inflated subscriber counting by Charter and Adelphia. *Id*. at 3-4.

[284] *Id.* at 4.

[285] *Id.* at 4.

[286] *Id* at 4-5.

[287] *Id.* at 5.

proposed remedies are inappropriate and would be counterproductive.[288]

90. We will continue to rely on widely accepted industry reports to establish the total number of U.S. MVPD subscribers. For purposes of establishing cable operators' market share and compliance with the horizontal rule provisions, the *1999 Cable Ownership Order* endorsed the use of any published, current, and widely cited industry data source to establish estimates of nationwide MVPD subscribership.[289] Section 613(f) directs the Commission to establish reasonable limits.[290] The *1999 Cable Ownership Order* accepted a certain degree of variance, estimation, and double counting, cognizant of the fact that the horizontal rule provisions are based on estimates.[291] Utilization of current, widely accepted industry data represents a reasonable means by which to gauge cable operators' share of the MVPD market and fulfills the Commission's mandate under the statute.[292] We reject CFA's contention that by relying on industry data, we improperly delegated our statutory obligations to monitor and regulate the cable industry. Utilization of industry data merely affords a reasonable means by which to estimate cable operators' market share. We agree with NCTA that the use of third-party industry-wide data conserves administrative resources and is consistent with this agency's reliance on industry data to carry out regulatory functions in other areas.[293]

91. We agree with CFA that cable operators should be expected to report their subscriber figures accurately. The Commission's rules require any cable operator serving 20 percent or more of nationwide MVPD subscribers to certify, prior to acquiring additional MVPDs, "that no violation of the national subscriber limits prescribed in this section will occur as a result of [its] acquisition [of additional cable systems]."[294] These rules do not prescribe a particular form of certification. We clarify here that certifications must be executed by an officer of the corporation and must state that the number of attributable subscribers served by the applicant is reported accurately in the certification. If this number varies from subscriber counts the cable operator has provided to the Commission in other contexts, other government agencies, financial institutions, or third-party publishers of industry-wide subscriber data, the certification shall disclose and explain the nature of such discrepancies.[295] We will consider specific allegations of misrepresentation on a case-by-case basis.

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[288] Letter from Daniel L. Brenner, Senior Vice President, NCTA, to Marlene H. Dortch, Secretary, FCC (Oct. 23, 2002) at 2 ("NCTA Oct. 23, 2002 *ex parte*").

[289] *See 1999 Cable Ownership Order*, 14 FCC Rcd at 19112 ¶ 35.

[290] *See* 47 U.S.C. § 533(f)(1); *Senate Report* at 80.

[291] *See 1999 Cable Ownership Order*, 14 FCC Rcd at 19112 ¶ 35.

[292] NCTA states that industry data research and reports are reliable, and are followed and utilized "by all segments of the video industry, not merely cable operators." NCTA Feb. 17, 2000 Opposition at 16. NCTA maintains that small operators will not inflate their numbers because their license fees are based on their actual subscribership, and large cable operators will not understate their numbers because they are required to report their compliance with the horizontal limit. *Id.* at 14-15.

[293] *E.g.*, 47 U.S.C. § 548(g) (annual assessment of MVPD competition); 47 U.S.C. § 159 (regulatory fees).

[294] *See* 47 C.F.R. § 76.503(g).

[295] Certifications need not identify each and every subscriber count that has been provided to another entity. Rather, they should explain whether the filing company has reported or routinely reports subscriber counts to other entities using methodologies that differ from those used for purposes of compliance with the Commission's horizontal limit.

III. FURTHER NOTICE OF PROPOSED RULEMAKING

A. Attribution

1. Background

92. The cable attribution rules seek to identify "those corporate, financial, partnership, ownership, and other business relationships that confer on their holders a degree of ownership or other economic interest, or influence or control over an entity engaged in the provision of communications services such that the holders should be subject to the Commission's regulation."[296] Similarly, the broadcast attribution rules define which financial or other interests in a licensee must be counted in applying the broadcast ownership rules, and seek to identify "those interests in or relationships to licensees that confer on their holders a degree of influence or control such that the holders have a realistic potential to affect the programming decisions of licensees or other core operating functions."[297] At the same time, the attribution rules "permit arrangements in which a particular ownership or positional interest involves minimal risk of influence, in order to avoid unduly restricting the means by which investment capital may be made available to the broadcast industry."[298] Depending on the particular substantive rule and objective to be accomplished, a variety of different attribution standards are used in the Commission's rules.[299]

93. *The General Attribution Standard.* In the cable television context, there are two strains of cable attribution rules: "the general attribution standard,"[300] relevant here, and the "program access attribution standard."[301] The general attribution standard, which applies to the cable horizontal

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[296] *See Implementation of the Cable Television Consumer Protection and Competition Act of 1992*, 14 FCC Rcd 19014, 19016 ¶ 2 (1999) (*1999 Cable Attribution Order*).

[297] *Regulations Governing Attribution of Broadcast and Cable/MDS Interests, Regulation and Policies Affecting Investment in the Broadcast Industry and Reexamination of the Commission's Cross Interest Policy*, 14 FCC Rcd 12559, 12560 ¶ 1 (1999) (*1999 Broadcast Attribution Order*), *recon. granted in part*, *Review of the Commission's Regulations Governing Attribution of Broadcast and Cable/MDS Interests*, *Review of the Commission's Regulations and Policies Affecting Investment in the Broadcast Industry, Reexamination of the Commission's Cross-Interest Policy*, 16 FCC Rcd 1097 (2001) (*Broadcast Ownership Reconsideration Order*), *stayed*, 16 FCC Rcd 22310 (2001).

[298] *See 1999 Broadcast Attribution Order,* 14 FCC Rcd at 12562-63 ¶ 5.

[299] The broadcast attribution rules are detailed in Note 2 of Section 73.3555 of the Commission's rules. *See* 47 C.F.R. § 73.3555 Note 2. In the cable context, as discussed below, there are two strains of attribution rules, the general attribution standard, which applies to the cable horizontal and vertical ownership rules, and the program access attribution standard. *See infra* ¶ 93. The Commission also applies attribution rules in other services not pertinent here, such as, for example, in the wireless context. *See* 47 C.F.R. § 1.919(2)(C)(ii).

[300] The general cable attribution standard applies to the horizontal ownership limits, 47 C.F.R. § 76.503; the channel occupancy limits, 47 C.F.R. § 76.504; the cable/SMATV cross-ownership limits, 47 C.F.R. § 76.501(d); the cable-telco buyout prohibition, 47 C.F.R. § 76.505; and the effective competition test, 47 C.F.R. § 76.905.

[301] The Commission adopted the more restrictive program access attribution standard for its rules imposing specific behavioral restraints on cable operators and programmers, such as its rules regarding program access and program carriage, "both of which were designed, in part, to prevent cable operators from using their market power to engage in improper conduct." *See Implementation of the Cable Television Consumer Protection and Competition Act of 1992, Review of the Commission's Cable Attribution Rules, Notice of Proposed Rulemaking*, 13 FCC Rcd 12990, 12993 ¶¶ 5-6 (1998) (*1998 Cable Attribution NPRM*). The program access attribution standard attributes an entity's stockholdings, whether voting or non-voting, and all partnership interests above 5 percent. The single majority shareholder exemption and insulated limited partner exceptions do not apply. *See 1999 Cable Attribution Order*, 14 FCC Rcd at 19018 ¶ 4. The program access attribution rules apply to cable commercial leased access, 47 C.F.R. § 76.970; program access, 47 C.F.R. § 76.1000; carriage discrimination, 47 C.F.R. § 76.1300; open video systems, 47 (continued….)

ownership limits and vertical channel occupancy limits, is similar to the broadcast attribution rules. As the Commission has noted, "the broadcast attribution standard governs broad structural rules, such as the horizontal cable ownership limits and vertical channel occupancy limits that are designed to ensure competition and diversity in the video marketplace."[302] The Commission also observed that the legislative history of the Cable Television Consumer Protection and Competition Act of 1992 expressly suggested use of the broadcast attribution standard in the context of the horizontal ownership and channel occupancy rules.[303] The general attribution standard and the broadcast attribution rules attribute corporate voting stock interests of five percent or more.[304] In other words, an investor owning five percent or more of the voting stock of a cable company will be attributed with all of that company's subscribers for purposes of the Commission's ownership limits. For specified "passive" institutional investors,[305] voting stock interests of 20 percent or more are attributable in both the cable and broadcast contexts.[306] Non-voting stock interests, options, warrants, and debt are not attributable, subject to the equity and debt (ED) rule in the cable context,[307] and the equity/debt plus (EDP) rule in the broadcast context,[308] both of which are discussed below.

94. Both the general cable attribution standard and the broadcast attribution rules include a single majority shareholder exemption, which provides that a minority shareholder's corporate voting interests will not be attributed where a single corporate shareholder owns more than 50 percent of the outstanding voting stock.[309] The Commission justified the exemption, which it first adopted for the broadcast attribution rules in 1984, on the grounds that without the agreement or assistance of any other shareholder, a minority shareholder cannot ordinarily direct the activities of a company when a single person or entity can outvote all other shareholders.[310] The Commission later found that the same

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C.F.R. § 76.1500; asset transfers between a cable operator and affiliate, 47 C.F.R. § 76.924(i); and rate pass-throughs for programming services between a cable operator and an affiliated programmer, 47 C.F.R. § 76.922(f)(6). The program access attribution standard is not at issue here.

302 *See 1998 Cable Attribution NPRM*, 13 FCC Rcd at 12993 ¶ 4 (citing *Implementation of Sections 11 & 13 of Cable Television Consumer Protection and Competition Act of 1992 – Horizontal and Vertical Ownership Limits*, 8 FCC Rcd 8565, 8568-69, 8577-79 (1993)).

303 *See 1999 Cable Attribution Order*, 14 FCC Rcd at 19017-18 ¶ 3; *1998 Cable Attribution NPRM*, 13 FCC Rcd at 12993 ¶ 4. *See also* Pub. L. No. 102-385, 106 Stat. 1460 (1992), 47 U.S.C. § 521, *et. seq*. (1992).

304 *See Corporate Ownership Reporting and Disclosure by Broadcast Licensees, Amendment of Sections 73.35, 73.240 and 73.636 of the Commission's Rules Relating to Multiple Ownership of Standard, FM and Television Broadcast Stations, Amendment of Sections 73.35, 73.240, 73.636 and 76.501 of the Commission's Rules Relating to Multiple Ownership of AM, FM, and Television Stations and CATV Systems, Reexamination of the Commission's Rules and Policies Regarding the Attribution of Ownership Interests in Broadcast, Cable Television, and Newspaper Entities*, 97 FCC 2d 997, 1005-06 ¶ 14-15 (1984) (*1984 Broadcast Attribution Order*), *recon. in part*, 58 R.R.2d 604 (1985), *further recon. granted in part*, 1 FCC Rcd 802 (1986) ("*1985 Attribution Reconsideration Order*"). *See also* 47 C.F.R. § 73.3555 Note 2(a).

305 Passive investors are "investment companies, as defined by 15 U.S.C. § 80a-3, insurance companies, and banks holding stock through their trust departments in trust accounts." 47 C.F.R. § 76.501 Note 2(b).

306 47 C.F.R. § 73.3555 Note 2(b); 47 C.F.R. § 76.501 Note 2(b).

307 47 C.F.R. § 76.501 Notes 2(e) & (i); *see also 1999 Cable Attribution Order*, 14 FCC Rcd at 19049-50 ¶¶ 88-89.

308 47 C.F.R. § 73.3555 Notes 2(e) & (i).

309 *See* former 47 C.F.R. § 73.3555 Note 2(b); former 47 C.F.R. § 76.501 Note 2(b).

310 *See 1984 Broadcast Attribution Order*, 97 FCC 2d 997, 1008-09 ¶ 21; *1999 Cable Attribution Order*, 14 FCC Rcd at 19044-46 ¶¶ 74-81.

rationale justified application of the exemption to the cable attribution rules.[311]

95. *EDP/ED Attribution Rules and Single Majority Shareholder Exemption.* In 1995, the Commission initiated a broad review of its broadcast attribution rules based on several considerations: (1) changes in the broadcasting industry and in the multiple ownership rules since its revision of the attribution rules ten years earlier and its consequent desire to ensure that the attribution rules remained effective in identifying interests to be counted for purposes of applying the multiple ownership rules; (2) concerns raised that certain nonattributable investments, while permissible under the rules in effect, may have permitted a degree of influence that warranted attribution; (3) concerns that individually permissible cooperative arrangements between broadcasters were being used in combination, resulting in significant influence in multiple stations that the multiple ownership rules were intended to prohibit; and (4) the need to address attribution treatment of Limited Liability Companies.[312]

96. In the *1999 Broadcast Attribution Order* proceeding, the Commission adopted the EDP attribution rule. Under the broadcast EDP attribution rule, where an investor is either (1) a major program supplier (supplying over 15 percent of a broadcast station's total weekly broadcast programming hours); or (2) a same-market media entity subject to the broadcast multiple ownership rules, its interest in a licensee or other media entity will be attributed if that interest, aggregating both debt and equity holdings, exceeds 33 percent of the total assets (equity plus debt) of the licensee or media entity.[313] In other words, attribution results where the financial interest exceeds 33 percent and there is a triggering relationship, *i.e.*, either the investor is a major program supplier or a same-market media entity subject to the broadcast multiple ownership rules. The EDP rule was intended to operate "in addition to other attribution standards and would attempt to increase the precision of the attribution rules, address our concerns about multiple nonattributable relationships, and respond to concerns about whether the single majority shareholder and nonvoting stock attribution exemptions were too broad."[314] The Commission targeted its remedy to address its concerns.[315]

97. In the *1999 Broadcast Attribution Order*, the Commission did not eliminate the single majority shareholder exemption. Rather, by adopting the EDP attribution rule, it narrowed the availability of that exemption. The EDP attribution rule limits the applicability not only of the single majority shareholder exemption, but also the limited partnership exemption and the exemptions for nonvoting stock and debt, under the broadcast attribution rules.[316]

98. In 1998, after commencing the broadcast attribution proceeding, the Commission also began a rulemaking to consider modifying the cable attribution rules, in light of developments in the cable industry, including numerous strategic alliances, partnerships, system swaps, and mergers and acquisitions of cable entities.[317] In the *1999 Cable Attribution Order*, the Commission revised several aspects of its cable attribution rules to track changes made to the broadcast attribution rules, and it adopted the cable ED attribution rule based on similar reasons expressed when it adopted the broadcast EDP rule. The cable ED rule attributes financial interests that exceed 33 percent of the total asset value (equity plus debt) of the entity in which the investment is held. Unlike the EDP rule, no other triggering

[311] *See 1993 Second Report and Order*, 8 FCC Rcd at 8580-81¶¶ 34-35.

[312] *1999 Broadcast Attribution Order*, 14 FCC Rcd at 12561 ¶ 2.

[313] 47 C.F.R. § 73.3555 Notes 2(a) & (i).

[314] *Id*. at 12573 ¶ 27.

[315] *Id*. at 12580 ¶ 41.

[316] *See 1999 Broadcast Attribution Order*, 14 FCC Rcd at 12579 ¶ 36.

[317] *1998 Cable Attribution NPRM*, 13 FCC Rcd at 12999 ¶ 16.

relationships are required for attribution under the ED rule where the requisite financial interest is present.[318] Both the EDP rule and the ED rule are designed to improve the precision of the Commission's attribution rules with respect to otherwise non-attributable interests by capturing those financial interests that afford the incentive and ability to exert significant influence, as well as those that create significant common economic interests.

99. In contrast to the Commission's decision to retain the single majority shareholder exemption in the broadcast attribution context and to adopt the EDP attribution rule to address concerns regarding the under inclusiveness of the attribution rules,[319] the Commission eliminated the single majority shareholder exemption from the general cable attribution rules in the *1999 Cable Attribution Order*. It found insufficient evidence to support retaining the exemption and expressed concern that a minority shareholder might be able to exert significant influence over a company even when a single majority shareholder exists.[320] Thereafter, on reconsideration of the broadcast attribution rules, the Commission eliminated the exemption in the broadcast context as well, relying, in part, on the rationale for eliminating the exemption in the cable context.[321]

100. The *Time Warner II* court reversed, remanded, and vacated the Commission's elimination of the single majority shareholder exemption in the cable attribution rules.[322] The court held that the Commission's decision to eliminate the single majority shareholder exemption in the cable context was not sufficiently justified and dismissed the Commission's stated rationales that there was no record to support retaining the exemption and that no one claimed to be using the exemption.[323] Finding that absence of current use is no reason to delete an exemption and that the removal of the exemption affected companies' investment plans, the court noted that the elimination was a "tightening of the regulatory screws" and therefore required some affirmative justification.[324]

101. The Commission subsequently suspended the elimination of the single majority shareholder exemption in the broadcast context as well, thereby allowing the exemption for the broadcast and cable/MDS[325] attribution rules pending resolution of this cable ownership proceeding.[326] While *Time*

318 *See 1999 Cable Attribution Order*, 14 FCC Rcd at 19047 ¶ 82.

319 *Review of the Commission's Regulations Governing Attribution of Broadcast and Cable/MDS Interests, Review of the Commission's Regulations and Policies Affecting Investment in the Broadcast Industry, Reexamination of the Commission's Cross-Interest Policy*, 11 FCC Rcd 19895, 19901 ¶ 12 (1996).

320 *1999 Cable Attribution Order*, 14 FCC Rcd at 19046 ¶ 81.

321 *Broadcast Ownership Reconsideration Order,* 16 FCC Rcd at 1116-17 ¶¶ 41-44.

322 *See Time Warner II*, 240 F.3d at 1139-43. The D.C. Circuit both vacated and remanded the Commission's decisions on the single majority shareholder exemption and the no sale prong of the ILP exemption. *See id.*, 240 F.3d at 1128, 1144.

323 *Time Warner II*, 240 F.3d at 1142-43.

324 *Id.* at 1143.

325 In 2004, the Commission changed the name of "Multichannel Distribution Services" to "Broadband Radio Service." *see Amendment of Parts 1, 21, 73, 74 and 101 of the Commission's Rules to Facilitate the Provision of Fixed and Mobile Broadband Access, Educational and Other Advanced Services in the 2150-2162 and 2500-2690 MHz Bands; Part 1 of the Commission's Rules - Further Competitive Bidding Procedures; Amendment of Parts 21 and 74 to Enable Multipoint Distribution Service and the Instructional Television Fixed Service Amendment of Parts 21 and 74 to Engage in Fixed Two-Way Transmissions; Amendment of Parts 21 and 74 of the Commission's Rules With Regard to Licensing in the Multipoint Distribution Service and in the Instructional Television Fixed Service for the Gulf of Mexico*; 19 FCC Rcd 14165 (2004) ("*MDS/ITFS Order"*).

Warner II did not directly address the Commission's elimination of the broadcast single majority shareholder attribution exemption, the Commission recognized that it had relied in part on the rationale rejected by the *Time Warner II* court in eliminating the exemption in the broadcast context.[327] The Commission also noted that a suspension would enable it to consider all evidence provided in response to its *2001 Further Notice* on whether to reinstate the single majority shareholder exemption in the broadcast context and that the suspension would allow consistent processing of pending and future applications, among other benefits.[328]

102. *Limited Partnership Interests.* Under the attribution rules governing partnership interests, general partnership and limited partnership interests are attributable regardless of the level of equity held.[329] An exception from attribution applies only to those limited partners who meet the Commission's insulation criteria. In setting specific guidance as to what kind of insulation is sufficient to exempt a limited partnership interest from attribution, the Commission originally established seven criteria, collectively referred to herein as the "ILP criteria," which, if met would make it safe to presume that a limited partner would not be materially involved in the management and operations of the media-related activities of the partnership.[330]

103. The Commission considers attribution in the partnership context separately from attribution in the corporate context because, in the abstract, all partners may bind the partnership, and because partnership governance is far more a matter of the terms of the specific partnership agreement than it is of any general standards mandated by law or practice.[331] Thus, for example, a partner contributing no equity might be entitled to a majority of the economic return or have very significant managerial control.[332] Also, the Commission has recognized that because of the flexibility a partnership structure offers, certain partners, like individual corporate shareholders, may be involved on a largely passive basis or without any significant potential to influence or control the partnership operations in a manner that should trigger the Commission's ownership rules. Accordingly, the Commission developed insulation criteria to recognize these circumstances.

(Continued from previous page)
[326] *See Order,* 16 FCC Rcd 22310 (2001) ("*Suspension Order*"). In the *2001 Further Notice*, adopted to address the issues on remand of the *Time Warner II* decision, the Commission incorporated, by reference, the three petitions for reconsideration and comments supporting reconsideration of the Commission's decision to eliminate the single majority shareholder exemption in the context of the broadcast attribution rules filed by NBC, Paxson, and Viacom. *See 2001 Further Notice*, 16 FCC Rcd at 17356-57 ¶ 91.

[327] *See Suspension Order*, 16 FCC Rcd at 22311-12 ¶ 4.

[328] *Id.*

[329] 47 C.F.R. § 76.501 Note 2(a).

[330] *1999 Cable Attribution Order*, 14 FCC Rcd at 19038 ¶ 57 n.163. The Commission adopted insulation criteria in the broadcast context because there is no uniform state law that establishes criteria with respect to the scope of permissible limited partner activities. State laws vary significantly and may fail to provide sufficient assurance that a limited partner will lack the ability to significantly influence or control the partnership's activities of concern. The Commission initially decided to use the Revised Uniform Limited Partnership Act ("RULPA") when determining which limited partnership interests should be attributed and which should be held exempt. Ultimately, however, the Commission rejected that approach. It noted that the RULPA provisions were not uniformly interpreted and that the scope of permissible limited partner activities was not statutorily set by the RULPA, but rather was determined by the limited partnership agreement. The Commission also decided that the RUPLA provisions did not provide adequate assurance that limited partners would not significantly influence or control partnership affairs. *1985 Attribution Reconsideration Order*, 1 FCC Rcd at 804 ¶ 9.

[331] *See id* at 803-04 ¶ 9.

[332] *See 1984 Broadcast Attribution Order*, 97 F.C.C.2d at 1022 ¶ 50; 47 C.F.R. §§ 73.3555 Notes 2(a)&(g), 76.501 Note 2(a), 76.503 Note 2(c).

104. In the *1999 Cable Attribution Order*, the Commission revised the attribution rules governing partnership interests. The sixth insulation criterion applicable to cable ownership had generally barred a limited partner from performing "any services to the partnership relating to its media activities." Based on concerns that the cable attribution ILP criteria might inhibit investments in cable Internet and telephony services, the Commission narrowed the sixth insulation criterion, in the cable context, to prohibit only services performed by the limited partner for the partnership that are materially related to the partnership's *video programming* activities. The Commission thereby broadened the range of activities that could be performed without loss of insulation for the limited partner.[333]

105. Thereafter, in its review of the *AT&T-MediaOne* license transfer application, the Commission clarified that the revised insulation criterion maintains the prior prohibition against a limited partner's sale of video programming to the partnership. Thus, a limited partner that operates cable systems and owns programming interests is prohibited from selling programming to the partnership ("the no-sale rule or criterion").[334] Noting the prior insulation criterion prohibiting the sale of services related to the media activities of the partnership, the Commission reasoned that, "given that a cable operator's core media activity is the provision of video programming, there is no service more material to a cable operator's video programming than the sale of programming to the cable operator."[335] The Commission also relied upon its interpretation of the sale of services insulation criterion in its *Twentieth Holdings* decision.[336] The Commission made clear that the revised insulation criterion was intended to allow a limited partner to insulate its partnership interest even if the partner participates in the partnership's other media activities, including the provision of telephony services, so long as the partner is not materially involved in the partnership's video-programming related activities. It also noted that the rule thus maintains the earlier prohibition against an insulated limited partner's sale of video programming to the partnership.[337]

106. The *Time Warner II* court reversed, remanded, and vacated the Commission's application of the cable limited partnership insulation rule that barred vertically integrated insulated limited partners from selling video programming to their general partner entities.[338] The court found that the no-sale

[333] *Id*. at 19039-41 ¶¶ 61-64; *Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from MediaOne Group, Inc., Transferor, to AT&T Corp., Transferee*, 15 FCC Rcd 9816, 9838 ¶ 45 (2000) (*AT&T-MediaOne Order*). In various filings, CFA challenges the modification of the insulation rule provisions for limited partners and for officers and directors for purposes of implementing the cable ownership limits. CFA argues that the *1999 Cable Attribution Order* impermissibly modified the insulation criteria in violation of Section 613(f). In opposition, NCTA asserts that the *1999 Cable Attribution Order's* adoption of the video programming insulation standard is consistent with the language and purpose of Section 613(f). In its comments, CFA reiterates arguments raised in its petition for reconsideration of the *1999 Cable Attribution Order*, which the Commission had dismissed as moot in the *2001 Further Notice*, 16 FCC Rcd at 17316 ¶ 2 n.11. We will address this issue in the Order arising out of the *Further Notice*.

[334] *See AT&T-MediaOne Order*, 15 FCC Rcd at 9839-40 ¶¶ 47-49 (finding that the no-sale rule is intended to determine whether a shareholder has the ability or influence to control a licensee but determining that under the facts of the transaction, adequate safeguards exist to protect against such influence); *see also AT&T-Comcast*, 17 FCC Rcd at 23279-82 ¶¶ 84-88.

[335] *AT&T-MediaOne Order*, 15 FCC Rcd at 9839-40 ¶ 47.

[336] *See Twentieth Holdings Corp. (Transferor) and Edward W. Brooke and Hugh L. Carey, Trustees* (*Transferees*), 4 FCC Rcd 4052, 4054 ¶¶ 15-17 (1989) (*Twentieth Holdings*).[336] Because video programming is at the heart of media activities, the Commission in *Twentieth Holdings* held that an investor in a broadcast station could not shield its investment from attribution if it sold video programming to the company in which the investment was made. *Id.*

[337] *AT&T-MediaOne Order*, 15 FCC Rcd at 9840 ¶ 48.

[338] *See Time Warner II*, 240 F.3d at 1139-43.

criterion is not rationally related to the goal of circumscribing a limited partner's control of, or influence on, the partnership's video programming decisions. The court recognized that a programmer might secure certain contractual terms giving the programmer some control over the programming choices of the partnership, but reasoned that the exercise of such power is barred by the criterion restricting communications related to the video programming business of the partnership. The court further noted that, even if the criterion did not bar such communications, "the bargaining opportunity would depend on the desirability of the partner's programming, not on its status as a partner."[339]

107. *2001 Further Notice.* In the *2001 Further Notice*, the Commission invited commenters to address, *inter alia*, the *Time Warner II* court's remand of the cable single majority shareholder exemption and the cable no-sale prong of the ILP exemption.[340] The Commission asked for empirical and/or theoretical evidence, including evidence from the cable industry or evidence based on studies of other industries, to support or contradict the Commission's prior decisions on these issues.[341] It also sought comment on whether to retain or eliminate the broadcast single majority shareholder exemption, having incorporated into the proceeding requests that the Commission reconsider eliminating that exemption.[342] We incorporate those petitions for reconsideration and comments into the record in this proceeding.[343] We issue this *Further Notice* to update the record and obtain more specific comment on all of these attribution issues.

2. Single Majority Shareholder Exemption

108. As discussed above, the Commission eliminated the single majority shareholder exemption from the general cable attribution rules because the record (1) failed to show that commenters were using this exemption and (2) lacked "credible arguments that it should be retained."[344] In the record to date, the majority of commenters support retaining the single majority shareholder exemption.[345] They state that the Commission has received no empirical evidence and little theoretical evidence to support eliminating the exemption, and no evidence of abuse or harm from the exemption.[346]

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[339] *Id.*

[340] *2001 Further Notice*, 16 FCC Rcd at 17355-56 ¶¶ 88-90, 17358-59 ¶¶ 93-97.

[341] *Id.*

[342] *Id.* at 17356-57 ¶¶ 91-92. *See also* National Broadcasting Company, Inc., Petition for Reconsideration, MM Docket Nos. 94-150, 92-51, and 87-154 (Mar. 12, 2001); Paxson Communications Corporation, Petition for Reconsideration, MM Docket Nos. 94-150, 92-51, and 87-154 (Mar. 15, 2001); Viacom Inc., Petition for Reconsideration, MM Docket Nos. 94-150, 92-51, and 87-154 (Mar. 15, 2001). These three petitions all challenged the Commission's reliance on the rationale for eliminating the exemption rejected by the *Time Warner* II decision, which is discussed below.

[343] *Id.*

[344] *1999 Cable Attribution Order*, 14 FCC Rcd at 19046 ¶ 81.

[345] *See*, *e.g.*, AT&T Comments to *2001 Further Notice* at 77-81; Media General Comments to *2001 Further Notice* at 3; Paxson Comments to *2001 Further Notice* at 3; Time Warner Comments to *2001 Further Notice* at 38-40; Viacom Comments to *2001 Further Notice* at 5-21; NAB Comments to *2001 Further Notice* at 5-10; Cablevision Comments to *2001 Further Notice* at 12-14; Comcast Comments to *2001 Further Notice* at 41-42; and Fox et. al. Reply Comments to *2001 Further Notice* at 3. Because the D.C. Circuit reversed and remanded the elimination of the single majority shareholder exemption, Comcast argues that it was effectively reinstated by the court's decision. *See* Comcast Reply Comments to *2001 Further Notice* at 41-42.

[346] *See*, *e.g.*, AT&T Reply Comments to *2001 Further Notice* at 29; Comcast Reply Comments to *2001 Further Notice* at 41-42; Paxson Comments to *2001 Further Notice* at 3; Viacom Comments to *2001 Further Notice* at 10; NAB Reply Comments to *2001 Further Notice* at 2; and Media General Comments to *2001 Further Notice* at 2, 5.

109. In this *Further Notice*, we seek to update the record. We tentatively conclude that the record to date supports reinstating the single majority shareholder exemption and seek comment on that general conclusion. We invite commenters to address whether the goals of the attribution rules -- capturing interests that convey the potential to exert significant influence such that they should be counted in applying the ownership rules, while not unduly restricting capital investment, as well as precision and regulatory certainty-- would be better served by retaining or eliminating the exemption. Can a minority shareholder in a corporation with a single majority shareholder exert significant influence or control such that its interest should be counted? If so, how can it exert such influence or control? We ask that commenters provide empirical or theoretical evidence to support their proposals or points of view. In particular, we seek comment on whether eliminating the exemption would have a negative impact on capital investment, particularly in small businesses. Although the *Time Warner II* decision addressed only the cable exemption, we tentatively conclude that the cable and broadcast single majority shareholder exemptions should be applied in the same manner to promote consistency in the processing of applications.[347] We seek comment on this tentative conclusion and on whether there is any reason to apply the exemption differently in the broadcast and cable contexts.[348]

110. Generally, the record in response to the *2001 Further Notice* supports the conclusion that the existence of a single majority shareholder sufficiently attenuates the voting power of minority shareholders such that it should not be a basis for attribution. While corporate management could ordinarily be expected to be influenced by a 5 percent shareholder who is one of the largest shareholders in a widely held corporation, we tentatively conclude that corporate management cannot be expected to be significantly influenced by a minority shareholder where there is a single majority shareholder. Further, as a general matter, a majority shareholder has the right to manage and control a corporation.[349] Therefore, we tentatively conclude that a single majority shareholder, absent a special shareholder agreement, would be able to outvote any minority shareholders on any issue, including the election of the corporation's board of directors.[350] We seek comment on these tentative conclusions.

111. We also invite comment as to whether other factors weigh in favor or against attribution of minority shareholders in a corporation with a single majority shareholder. Could a minority shareholder exert influence either by virtue of its access to confidential information or by threatening to sell shares to depress the share price?[351] Are there other situations in which contractual rights such as super-majority voting rights agreements afford minority shareholders voting power notwithstanding the general voting control of the single majority shareholder?

112. We have sought to make the Commission's attribution rules bright-line tests in order to

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[347] *Cf.*, S*uspension of the SMS Elimination Order*, 16 FCC Rcd at 22311-12 ¶ 4.

[348] We ask that parties submit comments only in MM Docket Nos. 92-264, 94-150, and CS Docket No. 98-82. All other proceedings referenced in the caption are being terminated or severed. *See supra* note 4.

[349] *See* AT&T Comments to *2001 Further Notice* at 77-78 (citing 12B FLETCHER CYCLOPEDIA OF PRIVATE CORPORATIONS § 5783); *see also* NAB Reply Comments to *2001 Further Notice* at 3; NCTA Comments to *2001 Further Notice* at 27 n. 54; Time Warner Comments to *2001 Further Notice* at 39; and Paxson Reply Comments to *2001 Further Notice* at 3.

[350] *See* Viacom Comments to *2001 Further Notice* at 8.

[351] Viacom notes that a minority shareholder's threat to trade the stock based on confidential information may be illegal. *See* Viacom Comments to *2001 Further Notice* at 16-17 (citing 17 C.F.R. § 243.100 (requiring that if a corporation discloses material, non-public information to one of its shareholders under circumstances in which it is reasonably foreseeable that the shareholder will either purchase or sell the corporation's shares on the basis of that information, the corporation must make a public disclosure of that information unless the shareholder expressly agrees to hold that information in confidence)).

provide reasonable certainty and predictability to our regulatees, to ease administrative processing, and to avoid unduly disrupting capital flow.[352] As a bright-line test, the single majority shareholder exemption may, like any other attribution limit or regulatory line an agency draws, miss some interests that could conceivably convey significant voting power or significant influence given special contractual rights or other factors. Are there such situations? If so, are these situations adequately covered by the EDP and ED attribution rules and by the Commission's "discretion to review individual cases that present unusual issues on a case-by-case basis where it would serve the public interest to conduct such a review"?[353]

3. Cable Insulated Limited Partnership Criteria

113. Under the insulated limited partnership or "ILP" criteria of the cable attribution rules, a limited partner can avoid attribution for purposes of Sections 76.501, 76.503, and 76.504 of the Commission's cable ownership rules if it is not "materially involved" in the management and operations of the partnership with respect to its video programming activities.[354] "Non-material" involvement is permitted in some significant partnership activities, without attribution, so that limited partners can ensure that their investments are protected.[355] More particularly, a limited partnership interest is not attributable for purposes of applying those ownership rules if it satisfies each of the following seven criteria, which are referenced in, but not included in, the rule and which identify those situations in which it is reasonable to assume no material involvement in partnership decisions by the limited partner.[356] A limited partner seeking to avoid attribution in the cable context cannot:

> (1) act as an employee of the partnership if his or her functions, directly or indirectly, relate to the video-programming enterprises of the company; (2) serve, in any material capacity, as an independent contractor or agent with respect to the partnership's video-programming enterprises; (3) communicate with the licensee or general partners on matters pertaining to the day-to-day operations of its video-programming business; (4) vote on the admission of additional general partners subject to the power of the general partner to veto any such admissions; (5) vote to remove a general partner except where the general partner is subject to bankruptcy proceedings, is adjudicated incompetent by a court of competent jurisdiction, or is removed for cause as determined by a neutral arbiter; (6) perform any services for the partnership materially relating to its video-programming activities, except that a limited partner may make loans to or act as a surety for the business; and (7) become actively involved in the management or operation of the video-programming businesses of the partnership.[357]

114. Following the court's decision in *Time Warner II*, a question remains regarding the extent to which a limited partner may engage in the sale of programming to the general partnership and still remain exempt from attribution. The court found no fault with the limitation on communications relating to video programming as an attribution insulation criterion, but it also found no basis for using

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[352] *See 1999 Broadcast Attribution Order*, 14 FCC Rcd at 12560, 12562, 12581 ¶¶ 1, 5, 43.

[353] *See id*. at 12581 ¶ 44.

[354] *See 1999 Cable Attribution Order*, 14 FCC Rcd at 19039-41 ¶¶ 61-64.

[355] *See Reexamination of the Commission's Rules and Policies Regarding the Attribution of Ownership Interests in Broadcast, Cable Television, and Newspaper Entities*, 1 FCC Rcd 802, 803 ¶ 6 (1986).

[356] *See 1999 Broadcast Attribution* Order, 14 FCC Rcd at 12615-16 ¶ 130; Reexamination *of the Commission's Rules and Policies Regarding the Attribution of Ownership Interests in Broadcast, Cable Television and Newspaper Entities*, 58 R.R.2d 604, 618-19 ¶ 46 (1985) (*1985 Broadcast Attribution Reconsideration Order*).

[357] *See* 47 C.F.R. § 76.503 Note 2(b)(2); 47 C.F.R. § 76.504 Note 1(b)(2); *1999 Cable Attribution Order*, 14 FCC Rcd at 19040-41 ¶ 64.

programming sales by the limited partner to the partnership to trigger attribution.[358] Left unclear is the manner and extent to which program promotions, sales, marketing, and contractual negotiations may take place without breaching the limitation on communications, as well as the scope of a limited partner's ability to perform services for the partnership materially related to its video programming activities without the interest being attributable.

115. The Commission received few comments on these issues in response to the *2001 Further Notice.* Although some commenters generally supported abandoning the "no-sale" provision of the cable limited partner insulation criteria, they did not address specifically whether a limited partner could sell programming to the partnership without violating the bar on communications with respect to the day-to-day operations of the video programming business.[359] While one commenter supported retaining the no-sale provision, it did not explain how the sale of programming to the partnership would increase the influence or control of the limited partner.[360] Therefore, we seek additional comment on this issue to address these issues and to update the record.

116. In particular, we seek comment with respect to the court's conclusion "that the no-sale criterion bears no rational relation to the goal" of ensuring that the limited partner will not be materially involved in the video-programming activities of the partnership.[361] Does the sale of programming to the partnership by a limited partner provide the limited partner with the ability or the incentive to influence the partnership to make specific decisions, and, if so, would the limited partner otherwise have no such ability or incentive absent its status as a seller of programming?

117. In reversing and remanding the prohibition on the sale of programming by an insulated limited partner, the court relied, in part, on the continued existence of the prohibition on communications with respect to the day-to-day operations of the video programming business. Thus, the court noted that a programmer might secure contract terms giving it some control over a partnership's programming choices, "but, given the independent criterion barring even communications on the video-programming business,… exercise of that power would seem to be barred."[362] The court also noted, however, that "even if it weren't, the bargaining opportunity would depend on the desirability of the partner's programming, not on its status as a partner."[363]

118. We ask commenters to address the court's conclusion that the sale of programming is not rationally related to the control of program choices. Does status as a limited partner affect the willingness of the partnership to carry the partner's programming? Does it affect the terms and conditions on which that programming is carried? Are there scenarios in which a limited partner could improve its bargaining position with respect to the sale of its programming to the partnership by virtue of its status as a limited partner? If so, how could the limited partner achieve such a result without engaging

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[358] *See Time Warner II*, 240 F.3d at 1143.

[359] *See* AT&T Comments at to *2001 Further Notice* 71-73, Time Warner Comments to *2001 Further Notice* at 41-42, Fox *et. al* Reply Comments to *2001 Further Notice* at 5; Comcast Reply Comments to *2001 Further Notice* at 42; AT&T Comments to *2001 Further Notice* at 71; and Time Warner Comments to *2001 Further Notice* at 40-41. The commenters note only that a limited partner cannot be materially involved in the video programming activities of the partnership because the limited partner is separately prohibited from communicating about day-to-day activities. They do not address how the two provisions relate.

[360] *See* CFA Reply Comments to *2001 Further Notice* at 27-28.

[361] *Time Warner II*, 240 F.3d at 1143 (stating that the Commission "has drawn no connection between the sale of programming and the ability of a limited partner to control programming choices.").

[362] *Id.*

[363] *Id.*

in other activities that would defeat insulation? Does the analysis change if the limited partner is a programming vendor but is not selling programming to the partnership at the time it seeks insulation?

119. We ask commenters to address the court's suggestion that a limited partner selling programming would be unable to influence or control the partnership's programming choices because of the prohibition on communications with respect to the day-to-day operations of the video programming business. Could influence deriving from the dual status as a program supplier and limited partner be exercised without communications? Should we draw a distinction between substantive communications and ministerial communications? Are there circumstances involving the sale of programming where all communications are so ministerial that they should be allowed even though the general prohibition on communications is retained? In that case, how should we enforce a general criterion that prohibits communication while permitting some communications to exist, and where do we draw the line between permitted ministerial communications and prohibited substantive communications?

120. Finally, should we reconsider and eliminate the ban on communications with respect to programming sales even though the court assumed the continued existence of that prohibition? If we were to allow communications with respect to the sale of programming, would that so narrow the bar on communications as to raise questions as to its continued utility? Are there other communications that should still be prohibited? For instance, should discussions regarding the purchase of competitors' programming or placement of competitors' programming on specific tiers be prohibited? If we retain a bar on some communications, how should we draw the line between prohibited communications and permitted ones?

4. Cable Equity Debt Attribution Rule

121. We propose to clarify the ED provision of the cable general attribution rules to correspond with and reflect the guidance provided in the Commission's reconsideration of the broadcast attribution rules.[364] As stated above, under the ED rule, a financial interest in a media entity is attributed if, aggregating debt and voting and non-voting equity interests, the interest exceeds 33 percent of a media entity's total assets (combining equity plus debt value). In order to promote clarity and certainty in applying the ED rule and maintain consistency with the general application of the broadcast EDP attribution rule, from which it is derived, we propose to clarify the ED rule provisions as follows.

122. *Options, Warrants, and Loan Guarantees*. In the *Broadcast Ownership Reconsideration Order*, the Commission clarified how it would apply the EDP rule to options, warrants, and loan guarantees. It specified that it would include the amount of consideration paid for options and warrants in determining whether the 33 percent benchmark is exceeded for purposes of applying the broadcast EDP attribution rule. Similarly, with respect to loan guarantees, it specified that it would include the security deposit or financial contribution made by the guarantor for the guarantee of a loan, including sums held in escrow as security, in determining whether the guarantor's interest exceeds the 33 percent threshold and the interest is therefore attributable under the EDP attribution rule. The Commission also clarified that it would add any consideration or other amounts paid for options or warrants to any other equity or debt investment the holder has in the media entity for purposes of determining whether the 33 percent threshold is exceeded. Similarly, it noted that it would include any financial contributions made by a guarantor to any other equity or debt investments the guarantor has in the media entity.[365] We propose to adopt the same clarifications for the ED attribution rule and seek comment on this proposal.

123. *Total Assets.* In the *Broadcast Ownership Reconsideration Order*, the Commission clarified the definition of "total assets" for purposes of applying the EDP rule. It clarified that it would include all equity and/or debt in whatever manner or amount held (*e.g.*, including all stock, non-stock,

[364] *Broadcast Ownership Reconsideration Order*, 16 FCC Rcd at 1112-15 ¶¶ 30-39.

[365] *Id*. at 1112-13 ¶¶ 31-32

partnership, and other equity interests, as well as all forms of short-term and long-term debt liabilities) in computing whether an interest exceeds the 33 percent EDP threshold. It also noted that parties could base the valuation of an entity's "total assets" on book value, as determined under standard financial accounting practices, or some other reasonable value, such as fair market value. It noted that clarifying the definition of total assets to include the foregoing reasonable methods of valuing a station's total assets for purposes of the EDP rule would provide applicants flexibility to use the most accurate valuation.[366] It also advised that media entities should retain the documentation upon which they compute the value of the station so it can produce supporting documentation for Commission review if needed.[367] We propose to adopt the same clarifications for purposes of applying the ED rule. As we did in the broadcast context, we also propose to reaffirm that parties must maintain compliance with the attribution criteria as any changes in a firm's assets occur.[368] We seek comment on these proposals.

124. *Multiplier*. As the Commission did in the *Broadcast Ownership Reconsideration Order*, we propose to amend the Commission's cable attribution rules to provide that in applying the ED rule, the "multiplier" formula of the general cable attribution rules will be utilized for identifying indirect, intervening interests, except that the pass-through exception for linkages that exceed a 50 percent interest, under which these interests are not multiplied, will not apply in the cable ED context as it does in the context of corporate voting stock.[369] In the *Broadcast Ownership Reconsideration Order*, the Commission noted that the multiplier was adopted because multiplication of successive interests would more realistically reflect a party's attenuated interest in a media entity where there are intervening corporations. Under the pass-through exception, however, a link in the ownership chain that represents a percentage interest exceeding 50 percent is treated as a 100 percent interest when calculating the successive links in the ownership chain. The Commission established the pass-through exception where an interest exceeds 50 percent to reflect the *de jure* control, rather than the *de facto* control, that an entity might have over a licensee. It noted that it would not apply the pass-through exemption in the EDP rule because the EDP rule applies not only to voting equity but also to non-voting equity and debt. It also clarified that it would use the multiplier in applying the EDP rule not only to corporations but also to financial interests in partnerships, limited liability companies, or any other type of organizational form.[370] We propose to apply these clarifications to the cable ED rule and seek comment on our proposal.[371]

B. Vertical Limit

1. Background

125. Section 613(f) of the Communications Act directs the Commission to "prescribe rules and regulations establishing reasonable limits on the number of channels on a cable system that can be occupied by a video programmer in which a cable operator has an attributable interest."[372] Among other things, in setting such limits, the Commission is directed to "ensure that cable operators affiliated with

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[366] *Id.* at 1112 ¶ 28.

[367] *Id*. at 1111 ¶¶ 27-28

[368] *Id*. at 1111-12 ¶ 29

[369] *Id*. at 1113-14 ¶¶ 33-35.

[370] *Id*. at 1114 ¶ 35

[371] In the *Broadcast Ownership Reconsideration Order*, the Commission clarified how the EDP rule would apply where an investor holds an interest in an entity that owns several stations in one market or multiple stations in several markets. It also clarified how it would apply the EDP rule to officers and directors. *Id*. at 1114-15 ¶ ¶ 36-39. We tentatively conclude that these clarifications are not relevant in the cable ED context because they relate mainly to issues related the EDP triggering prong. We invite comment on this tentative conclusion.

[372] *See* 47 U.S.C. § 533(f)(1)(A)-(B).

video programmers do not favor such programmers in determining carriage"[373] and to refrain from "impos[ing] limitations which would impair the development of diverse and high quality video programming."[374] In 1993, the Commission found that a 40 percent limit on the number of activated channels that can be occupied by affiliated video programming services struck an appropriate balance among the goals of reducing the incentive and ability of vertically integrated cable operators to favor their affiliated programming, increasing diversity, and permitting cable operators to realize the benefits and efficiencies associated with vertical integration.[375] The Commission also set a 75-channel cap on the 40 percent limit.[376] Thus, except for 40 percent of 75 channels of activated channel capacity (i.e., 30 channels), there was no limit on the amount of capacity that a cable operator could devote to affiliated programming. In 1995, the Commission affirmed both the 40 percent vertical limit and the 75-channel cap.[377]

126. The *Time Warner II* decision reversed and remanded the 40 percent channel occupancy limit, finding that the Commission had failed to justify its vertical limit with record evidence, and had failed adequately to consider the benefits and harms of vertical integration or current MVPD market conditions in its analysis.[378] The Commission sought comment on how it could fashion a meaningful and relevant channel occupancy limit given the changes that had occurred in the MVPD industry since the limit was first adopted.[379] The Commission also requested comment on the economic underpinnings of the statutory requirement and asked commenters to address the economic basis underlying the concern with vertical integration and market foreclosure.[380] Additionally, the Commission asked whether the necessary conditions existed in the MVPD industry for cable operators to engage profitably in vertical foreclosure and for this foreclosure to be harmful to the flow of programming.[381] It also sought comment on whether current and likely future developments in the MVPD market would mitigate past concerns regarding the ability of cable operators to discriminate against unaffiliated programming networks.[382]

127. In response, cable operators point to market forces that, they believe, make vertical foreclosure unlikely.[383] First, they state that a programmer can obtain carriage despite a cable operator's preference not to carry the programmer's service under several scenarios:[384] (1) where the programmer is

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[373] 47 U.S.C. § 533(f)(2)(B).

[374] 47 U.S.C. § 533(f)(2)(G). The Commission is also directed to consider the other public interest objectives listed in Section 613(f)(2). *See* 47 U.S.C. § 533(f)(2)(A), (C)-(F).

[375] *1993 Second Report and Order*, 8 FCC Rcd at 8593-95 ¶ 68.

[376] *See Implementation of Sections 11 and 13 of the Cable Television Consumer Protection and Competition Act of 1992, Horizontal and Vertical Ownership Limits*, Second Report and Order, 8 FCC Rcd 8565, 8567 ¶¶ 3-4 (1993).

[377] *See Implementation of Sections 11 and 13 of the Cable Television Consumer Protection and Competition Act of 1992, Horizontal and Vertical Ownership Limits,* Memorandum Opinion and Order on Reconsideration of the Second Report and Order, 10 FCC Rcd 7364 (1995).

[378] *Time Warner II*, 240 F.3d at 1137-39.

[379] *2001 Further Notice*, 16 FCC Rcd at 17350-51 ¶ 81.

[380] *Id*.

[381] *Id.*

[382] *Id*. at 17351-52 ¶ 83.

[383] *See*, *e.g.*, AT&T Comments to the *2001 Further Notice* at 50-54.

[384] *See id.* at 50-51; Comcast Comments to the *2001 Further Notice* at 25-28.

seeking carriage of a broadcast network entitled to "must carry" status under the Commission's rules;[385] (2) where the programmer is seeking carriage of a "must have" programming network that consumers demand; and (3) where the programmer is seeking carriage of a service pursuant to the Commission's leased access rules.[386] Second, they assert that discrimination on the basis of affiliation is already targeted by the program access rules.[387] Third, they argue that competition from alternative MVPDs such as DBS makes it unprofitable for a cable operator to engage in foreclosure, because failure to carry unaffiliated popular networks will drive customers to other MVPDs.[388] Lastly, they argue that market conditions have changed to make foreclosure unlikely, citing in particular cable systems' increased channel capacity.[389] In this regard, however, we note that cable operators have also complained, in other contexts, about capacity constraints because of the increased capacity demands of digital television, including high definition television, and their need to increase the speed of data services they provide.[390] Cable operators have also submitted studies that purport to show that they have no theoretical incentive to favor affiliated programming networks and not carry attractive unaffiliated programming networks;[391] that programmers could use alternative distribution channels (such as broadcast TV, foreign MVPDs, and DVD sales) if a cable operator attempted to foreclose rival networks;[392] that larger cable operators have tended to have more channel capacity and carry more channels;[393] that cable operators have not engaged in foreclosure in the past, and there has been plentiful entry by unaffiliated programming networks;[394] and that a cable operator's incentive to foreclose shrinks as its size increases.[395]

128. In the *2005 Second Further Notice*, the Commission discussed the empirical studies and comments submitted in the docket in 2001 and found that they were insufficient to establish whether vertical foreclosure is likely to occur in the current marketplace.[396] CFA had pointed to two academic studies that found that vertically integrated operators favor affiliated programming. AT&T and Time Warner provided evidence to the contrary.[397] Because the industry had undergone tremendous change, including increases in channel capacity, since these studies were performed, the Commission tentatively

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[385] *See* 47 C.F.R. § 76.56.

[386] *See* 47 C.F.R. § 76.701.

[387] Time Warner Comments to the *2001 Further Notice* at 35-37 (citing 47 U.S.C. § 536(a)(3); 47 C.F.R. §76.1301(c)).

[388] Cablevision Comments to the *2001 Further Notice* at 7-10; NCTA Comments to the *2001 Further Notice* at 21.

[389] Cablevision Comments to the *2001 Further Notice* at 7-9.

[390] *See Hearing on Completing the Digital Transition Before the S. Comm on Commerce, Science, and Transportation*, 109th Cong. (2005) (statement of Kyle McSlarrow, President, National Cable & Telecommunications Association).

[391] AT&T Comments to the *2001 Further Notice*, Besen Decl. at 6-8; AT&T Comments to the *2001 Further Notice* , Ordover Decl. at 48-52.

[392] AT&T Comments to the *2001 Further Notice*, Ordover Decl. at 52-65. Ordover focuses his analysis on program developers' ability to find outlets to distribute their programming, and not on the ability of a new programming network to enter the market.

[393] Time Warner Comments to the *2001 Further Notice*, Joskow and McLaughlin Decl. at 5-6.

[394] *Id*. at 2-4; AT&T Comments, Besen Decl. at 10-14.

[395] AT&T Comments to the *2001 Further Notice,* Besen Decl. at 14-20; AT&T Comments, Ordover Decl. at 48-52.

[396] *2005 Second Further Notice*, 20 FCC Rcd at 9439-42 ¶¶ 130-36.

[397] AT&T Comments to the *2001 Further Notice*, Besen declaration and Time Warner Comments to the *2001 Further Notice*, Joskow and McLaughlin declaration.

concluded that these studies offer little probative value in the Commission's analysis.[398] Thus, the Commission again sought theoretical and empirical evidence and comment to assist in the development of a reasonable limit and in the articulation of how the limit would address the statutory goals.[399] Moreover, the Commission found that cable operators may have an incentive to engage in vertical foreclosure.[400]

129. The Commission also rejected commenters' proposal that the Commission not set a vertical limit.[401] The Commission found that the statute expressly requires the Commission to establish a limit and concluded that it lacks the authority to forbear from setting a limit.[402] Moreover, the Commission determined that vertical integration can provide both harms and benefits, and there was insufficient evidence in the record to set a "reasonable" limit at that time.[403]

130. Addressing the Commission's request for comment on harms that might flow from vertical integration, TAC asserts that networks affiliated with MVPDs and major broadcasters routinely are favored over independently owned networks in violation of Section 613(f)(2)(B). Specifically, TAC claims that analysis of carriage decisions by Comcast and Time Warner demonstrates that these cable providers have placed their affiliated programming on more widely distributed tiers and have tended not to provide carriage to independent programming with a similar theme to their own affiliated programming.[404] Thus, TAC maintains that vertically integrated media companies have strong incentives

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398 *2005 Second Further Notice* at 20 FCC Rcd at 9439-40 ¶¶ 130-31.

399 *Id.* at 9446-47 ¶ 147.

400 *Id.* at 9442 ¶ 136. In response, Comcast and NCTA reiterate their arguments that cable operators do not have an incentive to engage in vertical foreclosure because of the presence of MVPD competition and of other distribution channels. Comcast Comments to the *2005 Second Further Notice* at 60-66; NCTA Comments to the *2005 Second Further Notice* at 4-7, 14-16.

401 Several commenters respond to the *2001 Further Notice* by asserting that the Commission should not adopt any channel occupancy rules and should not limit the carriage of affiliated programming. *See* Cablevision Comments to the *2001 Further Notice* at 5-11; Comcast Comments the *2001 Further Notice* at 29-33; NCTA Comments the *2001 Further Notice* at 20-23; Time Warner Comments the *2001 Further Notice* at 35-37. They assert that changes in the marketplace have eliminated the need for such limits and that therefore no channel occupancy limit can survive constitutional scrutiny. Cablevision Comments at 6 (arguing that given the technological advancements and today's "vigorously competitive" MVPD marketplace, no channel occupancy limit will survive constitutional scrutiny); NCTA Comments the *2001 Further Notice* at 11, 14 (contending that competition in the sale of video programming has effectively eliminated incentives to discriminate, and that if a cable operator refuses to carry attractive programming services, it will not only fail to attract subscribers and fail to maximize revenue from existing subscribers, it may lose subscribers). Other commenters assert, on the other hand, that horizontal concentration and vertical integration in the MVPD industry require that the Commission enact and enforce a strict channel occupancy limit. *See* CFA Comments the *2001 Further Notice* at 93-105 (arguing that vertical integration of cable firms facilitates the imposition of higher costs on programming rivals or a degradation in their quality of service (by withholding desired programming) to gain an advantage); Writer's Guild Comments at 15 (contending that the Commission should not only retain the existing 40 percent channel occupancy limit but also strengthen it through ownership limits on both cable and broadcast networks, regardless of whether the owner is a cable operator).

402 *2005 Second Further Notice,* 20 FCC Rcd at 9446-47 ¶ 147.

403 *Id.* at 9446 ¶ 146.

404 The America Channel provides analysis of how Comcast and Time Warner's carriage decisions varied according to tier and theme, based on an analysis of carriage decisions for new networks launched in the period of January 1, 2003 to May 15, 2005. It finds that Comcast and Time Warner have placed affiliated programming on analog and standard tiers, while unaffiliated programming has generally been relegated to digital or premium tiers that have less distribution or not provided carriage at all. It also examines the carriage of programming by theme and finds that Comcast and Time Warner provided carriage to affiliated programming networks but not independent networks for

(continued….)

to favor affiliated networks because they retain the value of the programming assets, whereas new independent networks compete with the affiliated channels for channel capacity, viewers, and advertising dollars.[405]

131. TAC contends that the expansion of digital capacity has not provided independent networks with additional carriage opportunities because of Comcast's practice of favoring carriage of affiliated networks.[406] Similarly, ACA asserts that the growth of digital capacity has not increased the carriage capacity for independent networks because retransmission-consent tying arrangements consume digital channel capacity and drain the resources that could be used for carriage of independent networks.[407] Moreover, ACA maintains that small and mid-sized cable systems often have no excess capacity and do not have the resources to upgrade to digital service.[408]

132. CFA also alleges a large list of harms likely to occur due to vertical integration of cable operators and video programming. Like TAC, CFA asserts that cable operators are more likely to carry their own programming and are also more likely to carry programming developed by broadcasters.[409] It also contends that vertical integration facilitates price squeezes, enhances price discrimination, forces potential competitors to enter in two stages of production, forecloses markets to competitors, and allows for easier cross-subsidization.[410] CWA asserts that increased vertical integration by cable operators, combined with national and regional concentration in the cable industry, as well as control by cable operators over valuable sports programming, has resulted in increased market power for the large cable operators.[411]

133. In 2001 and 2005, the Commission also sought comments and evidence on the benefits provided by vertical integration. In the *2001 Further Notice* the Commission asked commenters to discuss the benefits of vertical integration and the extent to which these benefits mitigate or outweigh the harms caused by cable operators favoring affiliated programming.[412] The Commission then asked how these benefits should affect the fashioning of a vertical limit. The Commission sought comment on the impact that relaxing or modifying the current limit of 40 percent might have on producing economic efficiencies, fostering innovation in services, and encouraging greater investment in and development of

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programming targeting the African-American, gay and lesbian, and English-speaking Latino communities. TAC Comments to the *2005 Second Further Notice* at 34-39; Exh.5.

[405] *See* TAC Comments to *2005 Second Further Notice* at 32-33. Time Warner criticizes TAC's survey on the grounds that TAC counts a channel as "affiliated" whenever it is owned by Comcast, Viacom, News Corp., NBC Universal, or Disney, which Time Warner claims disregards the lack of corporate affiliation with Time Warner and undercounts independent services that are most likely to succeed. *See* Time Warner Reply Comments to *2005 Second Further Notice* at 7-8.

[406] *See* TAC Comments to *2005 Second Further Notice* at 39-42.

[407] *See* ACA Comments to *2005 Second Further Notice* at 3-5.

[408] *See Id*. at 5-6.

[409] *See* CFA Comments to *2005 Second Further Notice* at 13-14. We otherwise received little comment on whether a cable operator's incentive and ability to engage in vertical foreclosure varies by type of programming network or by placement on different tiers.

[410] *See* CFA Comments to *2005 Second Further Notice* at 37-40. CFA contends that cable operators discriminate and use other anticompetitive practices by leveraging their control of distribution to defend their franchise product and concludes programmers must either own a wire or have transmission rights to be in the top tier of program networks. *See Id*. at 43-44; Exhibit 12.

[411] *See* CWA Comments to *2005 Second Further Notice* at 10-11.

[412] *2001 Further Notice*, 16 FCC Rcd at 17351 ¶ 82.

diverse and responsive programming.[413] The Commission also asked whether the existence of these benefits means that the Commission should employ alternative regulatory restrictions, other than imposing a limit on cable operators' carriage of affiliated programming, to prevent foreclosure.[414] In response, cable commenters maintain that vertical integration provides efficiencies by increasing the likelihood of financing for new networks and reducing the likelihood of "hold-up" (i.e., the cable operator demanding a lower price after the programming network has committed to entering and producing the programming).[415] They also argue that it eliminates the problem of double marginalization (i.e., both parties attempting to exercise market power by charging prices above cost), which occurs when both upstream and downstream firms attempt to exercise market power by charging above-cost prices.[416]

134. In the *2005 Second Further Notice* the Commission identified three kinds of benefits from vertical integration: (1) transaction efficiency, in which vertical integration prevents the post-transaction problems of "hold-up" and double-marginalization; (2) resources, where the cable operator provides the additional resources needed for a new network to survive; (3) signaling commitment, in which vertical integration signals that the programming network is likely to succeed, which may allow new programmers access to capital from sources other than the affiliated MVPD and the ability to acquire talent and content.[417] The Commission concluded that cable commenters had failed to demonstrate that the benefits of vertical integration will always exceed the potential harms from vertical foreclosure. The Commission found that the cable commenters also failed to identify those circumstances in which the benefits from a particular vertical investment or merger are large enough to warrant exemption from the vertical limit.[418]

2. Discussion

135. The record developed in response to the *2005 Second Further Notice* remains inadequate to support a specific vertical limit. No commenter proposed a specific limit, provided us with evidence to support a specific limit, advanced any methodology that could help us to determine a specific limit, or demonstrated a link between any of the harms identified and a specific limit designed to prevent these harms.[419] As detailed below, we again seek comments and evidence on these issues.

136. First we ask for comment on how to define the programming and distribution markets for purposes of determining an appropriate channel occupancy limit.[420] In 2001, the Commission proposed that programming could be classified into two broad categories, general entertainment and niche programming.[421] The Commission also suggested that programming networks vary according to whether they focus on a particular subject or are more general purpose, whether they gain a large nationwide

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[413] *Id*. at 17352 ¶ 84.

[414] *Id*. at 17351 ¶ 82.

[415] Time Warner Comments to the *2001 Further Notice*, Joskow and McLaughlin Decl. at 22.

[416] *Id*. at 23.

[417] *2005 Second Further Notice*, 20 FCC Rcd at ¶¶ 156-59.

[418] *Id.* at 9449 ¶ 155.

[419] Commenters address issues related to vertical integration, such as digital capacity, the issue of whether vertically integrated cable operators discriminate in favor of affiliated programming, and generalized complaints about anticompetitive effects of vertical integration. *See* CFA Comments to *2005 Second Further Notice* at 13-14, 37-40, 43-46; CWA Comments to *2005 Second Further Notice* at 10-11. No commenter, however, links any of these issues to a specific vertical limit.

[420] *2005 Second Further Notice*, 20 FCC Rcd at 9447 ¶ 148.

[421] *2001 Further Notice*, 16 FCC Rcd at 17321 ¶ 9.

audience, how narrowly focused they are in a particular subject, and whether they are national or regional in scope.[422] The Commission asked, in 2005, whether the incentive and ability of cable operators to engage in vertical foreclosure could vary according to the type of programming network and whether a channel occupancy limit would prevent discrimination in a particular submarket.[423] The Commission also sought comment on whether placement of networks on different tiers or in different packages affects how vertical foreclosure might be implemented by a cable operator, especially considering that digital tiers have much greater channel capacity than analog tiers, and whether a vertical limit should be applied on a tier-specific or package-specific basis.[424] We urge commenters to address these issues.

137. We also seek further comment on the extent to which vertically integrated cable operators have an incentive to engage in strategic, anticompetitive behavior, leading to foreclosure of entry by unaffiliated programmers.[425] We ask whether, in today's marketplace, vertically integrated cable operators have an incentive to discriminate unfairly against unaffiliated programming networks that compete against the cable operator's affiliated networks. In this regard we ask whether the Commission's finding that cable operators may have an incentive to engage in vertical foreclosure remains valid in today's marketplace and ask for analyses and studies based on current technological and market conditions.[426] As noted above, the Commission received little comment directly addressing its request for theoretical and empirical evidence regarding how to establish the vertical limit. The Commission did receive, however, two academic studies that particularly address whether cable operators have in recent years engaged in vertical foreclosure and whether they have favored their affiliated programming networks.[427]

138. Chen and Waterman use a 2004 database of 680 cable systems to examine whether Comcast and Time Warner are more likely to carry a program network in which they have an ownership interest than they are to carry a program network with similar content but in which they do not have an ownership interest. They find that vertical foreclosure is a persistent phenomenon in the cable industry despite channel capacity expansion, digitization, and DBS competition. The paper finds that vertically integrated cable operators (1) are more likely to carry a program network in which they have an ownership interest than they are to carry a program network with similar content but in which they do not have an ownership interest; and (2) when they do carry an unaffiliated program network with content similar to one of their affiliated networks, they tend to position the unaffiliated network on digital tiers or in other ways that limit consumer access.[428]

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[422] *Id*. at 17322-23 ¶¶ 12-13.

[423] *2005 Second Further Notice*, 20 FCC Rcd at 9447 ¶ 148.

[424] *Id.* at 9447 ¶ 149.

[425] *See Senate Report* at 25-27, 81; *House Report* at 41; *1995 Vertical Reconsideration Order*, 10 FCC Rcd at 7365 ¶ 4; *1993 Second Report and Order*, 8 FCC Rcd at 8583-84 ¶¶ 41-42; *Initial Notice*, 8 FCC Rcd at 218 ¶¶ 42-43; *2005 Second Further Notice* at para. 146. *Cf. generally Program Access Order*, 17 FCC Rcd at 12135-50 ¶¶ 24-55 (discussing ability and incentive of vertically integrated programming networks to favor affiliated cable operators).

[426] *2005 Second Further Notice* at ¶ 136.

[427] In his study of programming network carriage by cable systems, based on a sample of 11 networks, Goolsbee found that vertical integration generally increases the probability of carriage. He also found that increased DBS share in a market reduces this probability, suggesting that the propensity for self-carriage is driven more by market power considerations than by efficiencies from vertical integration. Austan Goolsbee, *Vertical Integration and the Market for Broadcast and Cable Television Programming* (April 2007) (MB Docket No. 06-121).

[428] Dong Chen and David Waterman, *Vertical Foreclosure in the U.S. Cable Television Market: An Empirical Study of Program Network Carriage and Positioning* (Aug. 2005).

139. In addition, a paper by Kang analyzes carriage decisions of 943 cable systems to test whether large MSOs might be colluding tacitly by carrying each others' vertically integrated cable networks, which the paper refers to as "reciprocal carriage."[429] The study finds that: (1) vertically integrated MSOs are more likely than non-vertically integrated MSOs to carry the start-up basic cable networks of other MSOs, and (2) vertically integrated MSOs are no more likely than non-vertically integrated MSOs to carry independent start-up basic cable networks. The study concludes that the Commission was correct to assume that the policy concern about excessive market power of cable operators in the programming market extends beyond the unilateral actions of individual MSOs.

140. Comcast disagrees with the findings of Chen and Waterman and Kang. Comcast contends that Chen and Waterman's conclusions are not supported by their findings, and that because programming on each channel tends to be unique, cable operators are motivated to carry programs that consumers will find attractive, regardless of whether an affiliated or unaffiliated network is the provider.[430] It asserts that Kang's conclusions are based on a six-year old data sample that skews results and uses assumptions unsupported by evidence.[431]

141. We seek comment on the validity of these studies and the responses to them. Do these studies establish that vertical foreclosure is occurring despite recent changes in the marketplace? Does Kang's study show that a more extended form of vertical foreclosure exists, based on "reciprocal carriage" of integrated programming, in which a coalition of cable operators unfairly favor each others' affiliated programming? Does carriage of an affiliated programming network reflect unfair discrimination against independent programming networks, which can deny consumers the ability to receive the programming they want, or is it simply a cost-minimizing move by a cable operator seeking to avoid paying affiliation fees, which may be more efficient and may enable cable operators to carry more programming that consumers desire?

142. We also seek comment on evidence regarding the benefits of vertical integration between cable operators and programming networks, and on their size relative to the potential harms of vertical integration. Both Congress and the Commission have recognized that vertical integration can produce efficiencies in the production, distribution, and marketing of video programming, enabling cable operators to make additional investments in distribution plant and programming.[432] Accordingly, we seek comment and evidence, as we did in the *2005 Second Further Notice*, to assist in the establishment of a reasonable channel occupancy limit, taking into consideration these benefits.

143. We invite commenters to propose a specific vertical limit, including whether or not the current 75 channel cap is still appropriate and relevant. We tentatively conclude that the 75-channel cap should be eliminated. We ask that commenters provide theoretical or empirical evidence to support any specific proposed limit and discuss how the proposed limit will appropriately balance the potential harms and benefits of vertical integration. Alternatively, we invite commenters to advance a particular methodology and rationale that will help us to determine a specific limit that is supported by record evidence. In either case, we request that commenters demonstrate a link between the specific harms sought to be prevented and the specific limit proposed to prevent or remedy such harms.

144. We also seek comment on whether the channel occupancy limit should apply to regional

[429] Jun-Seok Kang, *Reciprocal Carriage of Vertically Integrated Cable Networks: An Empirical Study.*

[430] Comcast Reply Comments to the *2005 Second Further Notice* at 19-23, citing Exhibit 1.

[431] *Id*. at 17-19, citing Exhibit 1.

[432] *See Senate Report* at 26-27, 81; *House Report* at 41; *1995 Vertical Reconsideration Order*, 10 FCC Rcd at 7365-66 ¶¶ 5-6; *1993 Second Report and Order*, 8 FCC Rcd at 8584-85 ¶¶ 43-44; *Initial Notice*, 8 FCC Rcd at 218-19 ¶¶ 44-45; *2005 Second Further Notice* at ¶ 146.

programming networks. In describing the limit on a cable operator's carriage of affiliated programming networks, the Commission's rule states that the limit applies to "national video programming services" owned by the cable operator or in which the cable operator has an attributable interest.[433] The Commission stated when it adopted this language that a programming service does not have to be distributed in every state to be regarded as a national programming service.[434] A programming service distributed to cable systems in numerous states across the country or in a variety of regions may also be considered a national programming service.[435] Programming services distributed only to a particular community or to a discrete region, on the other hand, are exempt from the limit.[436] The Commission explained that the application of the limit only to "national" networks would preserve cable operators' incentives to invest in the development of local and regional programming services and would thereby serve the Commission's goal of promoting localism.[437] Since 1993, when the Commission implemented this rule, regional networks have proliferated. Whereas in 1998 there were 61 regional networks, 24 of which were affiliated with one or more cable MSOs,[438] in 2005, there were 96, of which 44 were affiliated with at least one cable MSO.[439] Does the proliferation of regional networks since the Commission first adopted its channel occupancy limit support continued application of the limit only to nationally distributed networks, or does this marketplace development suggest that the limit should now apply to networks that are distributed in discrete geographic regions? Commenters supporting a broadened application of the limit should discuss the effects of any such revision on cable operators' incentives to continue investing in the development of regional programming and on the Commission's localism goal. In addition, commenters who advocate continued exclusion of any type of non-national programming should explain how the excluded class of programming should be defined and should explain how their proposed definitions would serve the statutory goals of promoting competition and diversity and should discuss any resulting effects on localism.

145. Finally, we seek comment on whether or not to expand the class of networks that count toward the channel occupancy limit. Currently, the limit applies only to networks that are affiliated with the cable operator whose compliance is at issue. Should we revise the rule so that it also limits the number of channels that can be occupied by video programming networks owned by or affiliated with (1) any cable operator, i.e., not just the operator whose compliance is at issue, (2) other MVPDs, such as DBS providers and/or (3) broadcast networks. We tentatively conclude that we should expand the channel occupancy limit to include video programming networks owned by or affiliated with any cable operator.[440] Congress did not distinguish between different types of cable operators for purposes of

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[433] 47 C.F.R. § 76.504(a) (2007).

[434] See *In the Matter of Implementation of Sections 11 and 13 of Cable Television Consumer Protection Act of 1992 Horizontal and Vertical Ownership Limits*, Second Report and Order, 8 FCC Rcd 8566, 8599, ¶ 78 (1993) ("Second Report and Order")

[435] *Id.*

[436] *Id*.

[437] *Id.*

[438] *1998 Video Competition Report*, 13 FCC Rcd at 24380-81, 24439-41 ¶ 171, Appendix D, Table D-3.

[439] *2005 Video Competition Report*, 21 FCC Rcd at 2579, ¶ 166.

[440] We note that, in adopting the exclusive contract prohibition in Section 628(c)(2)(D), Congress applied the prohibition to *all* cable operators. *See* Program Access Order 22 FCC Rcd 17791, 17840-1¶71. *See also* H.R. Rep No. 102-862, at 2 (1992) (Conf. Rep.):

> The cable industry has become vertically integrated; cable operators and cable programmers often have common ownership. As a result, cable operators have the incentive and ability to favor their affiliated programmers. This could make it more difficult for noncable-affiliated programmers to secure *1461

(continued….)

Section 628(c)(2)(D)."[441] Commenters are asked to provide a comprehensive analysis of why such revisions would be appropriate and necessary in order to enhance effective competition. Furthermore, because Section 613(f)(2) applies only to the actions of cable operators, commenters should discuss the jurisdictional basis for any revisions to the class of networks that are subject to the cap.

IV. PROCEDURAL MATTERS

A. Fourth Report and Order

146. **Paperwork Reduction Act Analysis**. This document does not contain new or modified information collection requirements subject to the Paperwork Reduction Act of 1995 (PRA), Public Law 104-13. In addition, therefore, it does not contain any new or modified "information collection burden for small business concerns with fewer than 25 employees," pursuant to the Small Business Paperwork Relief Act of 2002, Public Law 107-198, *see* 44 U.S.C. 3506(c)(4).

147. **Congressional Review Act.** The Commission will send a copy of this Fourth Report and Order in a report to be sent to Congress and the Government Accountability Office, pursuant to the Congressional Review Act.[442]

148. **Final Regulatory Flexibility Analysis.** As required by the Regulatory Flexibility Act,[443] the Commission has prepared a Final Regulatory Flexibility Analysis ("FRFA") relating to this Fourth Report and Order. The SFRFA is set forth in Appendix B.

B. Further Notice of Proposed Rulemaking

149. **Ex Parte Rules.** This is a permit-but-disclose notice and comment rulemaking proceeding. Ex parte presentations are permitted, except during the Sunshine Agenda period, provided that they are disclosed as provided in the Commission's rules. *See generally* 47 C.F.R. §§ 1.1202, 1.1203, and 1.1206(a).

150. Pursuant to sections 1.415 and 1.419 of the Commission's rules, 47 CFR §§ 1.415, 1.419, interested parties may file comments and reply comments on or before the dates indicated on the first page of this document. Comments may be filed using: (1) the Commission's Electronic Comment Filing System (ECFS), (2) the Federal Government's eRulemaking Portal, or (3) by filing paper copies. *See Electronic Filing of Documents in Rulemaking Proceedings*, 63 FR 24121 (1998).

- Electronic Filers: Comments may be filed electronically using the Internet by accessing the ECFS: http://www.fcc.gov/cgb/ecfs/ or the Federal eRulemaking Portal: http://www.regulations.gov. Filers should follow the instructions provided on the website for submitting comments.

    - For ECFS filers, if multiple docket or rulemaking numbers appear in the caption of this proceeding, filers must transmit one electronic copy of the comments for each docket or rulemaking number referenced in the caption. In completing the transmittal screen, filers should include their full name, U.S. Postal Service mailing address, and the applicable docket or rulemaking number. Parties may also submit an electronic comment by

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carriage on cable systems. Vertically integrated program suppliers also have the incentive and ability to favor their affiliated cable operators over nonaffiliated cable operators and programming distributors using other technologies.

[441] *Id.* at ¶ 72.

[442] *See* 5 U.S.C. § 801(a)(1)(A).

[443] *See* 5 U.S.C. § 604.

Internet e-mail. To get filing instructions, filers should send an e-mail to ecfs@fcc.gov, and include the following words in the body of the message, "get form." A sample form and directions will be sent in response.

- Paper Filers: Parties who choose to file by paper must file an original and four copies of each filing. If more than one docket or rulemaking number appears in the caption of this proceeding, filers must submit two additional copies for each additional docket or rulemaking number.

  Filings can be sent by hand or messenger delivery, by commercial overnight courier, or by first-class or overnight U.S. Postal Service mail (although we continue to experience delays in receiving U.S. Postal Service mail). All filings must be addressed to the Commission's Secretary, Office of the Secretary, Federal Communications Commission.

  - The Commission's contractor will receive hand-delivered or messenger-delivered paper filings for the Commission's Secretary at 236 Massachusetts Avenue, NE, Suite 110, Washington, DC 20002. The filing hours at this location are 8:00 a.m. to 7:00 p.m. All hand deliveries must be held together with rubber bands or fasteners. Any envelopes must be disposed of before entering the building.

  - Commercial overnight mail (other than U.S. Postal Service Express Mail and Priority Mail) must be sent to 9300 East Hampton Drive, Capitol Heights, MD 20743.

  - U.S. Postal Service first-class, Express, and Priority mail must be addressed to 445 12th Street, SW, Washington DC 20554.

People with Disabilities: To request materials in accessible formats for people with disabilities (Braille, large print, electronic files, audio format), send an e-mail to fcc504@fcc.gov or call the Consumer & Governmental Affairs Bureau at 202-418-0530 (voice), 202-418-0432 (tty).

151. This document does not contain proposed information collection(s) subject to the Paperwork Reduction Act of 1995 (PRA), Public Law 104-13. In addition, therefore, it does not contain any new or modified "information collection burden for small business concerns with fewer than 25 employees," pursuant to the Small Business Paperwork Relief Act of 2002, Public Law 107-198, *see* 44 U.S.C. 3506(c)(4).

152. **Supplemental Initial Regulatory Flexibility Analysis.** As required by the Regulatory Flexibility Act,[444] the Commission has prepared a Supplemental Initial Regulatory Flexibility Analysis (SIRFA) of the possible significant economic impact on a substantial number of small entities of the proposals addressed in this *Further Notice of Proposed Rulemaking*. The SIRFA is set forth in the Appendix. Written public comments are requested on the SIRFA. These comments must be filed in accordance with the same filing deadlines for comments on the *Further Notice*, and they should have a separate and distinct heading designating them as responses to the SIRFA.

153. **Additional Information.** For additional information on this proceeding, please contact Elvis Stumbergs, Industry Analysis Division, Media Bureau at (202) 418-2330. For Press Inquiries, please contact Mary Diamond, Media Bureau, at (202) 418-7200.

V. ORDERING CLAUSES

154. Accordingly, IT IS ORDERED, that pursuant to the authority contained in sections 2(a),

[444] *See* 5 U.S.C. § 603.

4(i), 303, 307, 309, 310, and 613 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 152(a), 154(i), 303, 307, 309, 310, 533, the *Fourth Report and Order* and *Further Notice of Proposed Rulemaking* are ADOPTED.

155. IT IS FURTHER ORDERED, pursuant to Sections 4(i), 303 and 613 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154(i), 303 and 533, that the amendment to 47 C.F.R. § 76.503 discussed in this *Fourth Report and Order* IS ADOPTED. The amendment shall become effective 30 days after publication in the Federal Register.

156. IT IS FURTHER ORDERED, that pursuant to authority contained in sections 2(a), 4(i), 303, 307, 309, 310, and 613 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 152(a), 154(i), 303, 307, 309, 310, 533, NOTICE IS HEREBY GIVEN of the proposals described in the *Further Notice of Proposed Rulemaking*.

157. IT IS FURTHER ORDERED, that the Commission's Consumer and Governmental Affairs Bureau, Reference Information Center, SHALL SEND a copies of the *Fourth Report and Order*, including the Final Regulatory Flexibility Analysis and the *Further Notice of Proposed Rulemaking*, including the Supplemental Initial Regulatory Flexibility Analysis to the Chief Counsel for Advocacy of the Small Business Administration.

158. IT IS FURTHER ORDERED, that MM Docket No. 87-154 and CS Docket No. 96-85 are TERMINATED and MM Docket No. 92-51 is SEVERED.

FEDERAL COMMUNICATIONS COMMISSION

Marlene H. Dortch
Secretary

APPENDIX A
LIST OF COMMENTERS

Initial Comments

The America Channel (TAC)
American Telephone & Telegraph (AT&T)
American Cable Association (ACA)
Doug Chen
Cablevision Systems Corporation (Cablevision)
Comcast Corporation (Comcast)
Communications Workers of America (CWA)
Consumer Federation of America (CFA)
DIRECTV, Inc.
ION Media Networks (Paxson)
Jun-Seok Kong
Media Access Project (MAP)
Media General, Inc.
National Cable Television Association (NCTA)
National Hispanic Media Coalition (NHMC)
Project and Freedom Foundation (PFF)
Alexander Raskovich
Time Warner Cable (Time Warner)
Viacom, Inc.
Daniel Waterman
Writers Guild of America (Writers Guild)

Supplemental Comments

Comcast Corporation (Comcast)

Further Supplemental Comments

Comcast Corporation (Comcast)

Opposition and Reply Comments

National Cable Television Association (NCTA)

Reply Comments

American Telephone & Telegraph (AT&T)
Comcast Corporation (Comcast)
National Association of Broadcasters (NAB)
ION Media Networks (Paxson)
Time Warner Cable, Inc. (Time Warner)

APPENDIX B

RULE CHANGES

Part 76 of Title 47 of the Code of Federal Regulations is amended to read as follows:

PART 76 MULTICHANNEL VIDEO AND CABLE TELEVISION SERVICE

1. The authority citations for part 76 continue to read as follows:

AUTHORITY: 47 U.S.C. §§ 152(a), 154(i), 303, 307, 309, 310, 533.

2. Section 76.503 is amended by:

a) Revising paragraph (a) to read as follows:

§ 76.503(a) National subscriber limits. No cable operator shall serve more than 30 percent of all multichannel-video programming subscribers nationwide through multichannel video programming distributors owned by such operator or in which such cable operator holds an attributable interest.

b) Replacing the text in subsections (b), (c), and (d) with the word "Reserved."

APPENDIX C

FINAL REGULATORY FLEXIBILITY ANALYSIS

As required by the Regulatory Flexibility Act of 1980, as amended (RFA),[1] an Initial Regulatory Flexibility Analysis (IRFA) was incorporated in the *2005 Second Further Notice of Proposed Rulemaking* in MB Docket No. 92-264, FCC 05-96.[2] The Commission sought written public comment on the proposals in the *2005 Second Further Notice*, including comment on the IRFA. This present Final Regulatory Flexibility Analysis (FRFA) conforms to the RFA.[3]

A. Need for, and Objectives of, this Fourth Report and Order

In this Fourth Report and Order, we set the Commission's cable horizontal ownership limit4 to bar cable operators from having an attributable interest in cable systems serving more than 30 percent of multichannel video programming subscribers nationwide. Our action here responds to the court's decision in Time Warner Entertainment Co. v. FCC ("Time Warner II"),[5] which remanded the Commission's 30 percent limit. Our decision implements the statutory directive that we impose a limit designed to ensure that no single cable operator or group of operators, because of their size, unfairly impede the flow of programming to consumers.[6]

In establishing the 30 percent cable horizontal ownership limit, we rely on a modified "open field" approach to ensure that no single cable operator becomes so large that a programming network can survive only if that largest operator carries it. To calculate a horizontal limit that meets this test, we first determine the minimum number of subscribers a network needs in order to survive in the marketplace, and then estimate the percentage of subscribers a network is likely to serve once it secures a carriage contract. The resulting calculation indicates that an open field of 70 percent and an ownership limit of 30 percent are necessary to ensure that no single cable operator is able to impede unfairly the flow of programming to consumers.

B. Summary of Significant Issues Raised by Public Comments in Response to the IRFA

None of the parties in this proceeding filed comments on how issues raised in the 2001 Further Notice or the 2005 Second Further Notice would impact small entities.

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

The RFA directs agencies to provide a description of, and, where feasible, an estimate of, the number of small entities that may be affected by the rules adopted herein.[7] The RFA generally defines the term

[1] *See* 5 U.S.C. § 603. The RFA, *see* 5 U.S.C. § 601 – 612, has been amended by the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA), Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996).

[2] *The Commission's Cable Horizontal and Vertical Ownership Limits,* Second Further Notice of Proposed Rulemaking, 20 FCC Rcd 9374, 9453 ¶ 165 (2005) ("*2005 Second Further Notice*").

[3] *See* 5 U.S.C. § 604.

[4] 47 C.F.R. § 76.503.

[5] *Time Warner Entertainment Co. v. FCC*, 240 F.3d 1126 (D.C. Cir. 2001).

[6] 47 U.S.C. § 533(f)(2)(A).

[7] 5 U.S.C. § 604(a)(3).

"small entity" as having the same meaning as the terms "small business," "small organization," and "small governmental jurisdiction."[8] In addition, the term "small business" has the same meaning as the term "small business concern" under the Small Business Act.[9] A "small business concern" is one which: (1) is independently owned and operated; (2) is not dominant in its field of operation; and (3) satisfies any additional criteria established by the Small Business Administration (SBA).[10]

Cable and Other Program Distribution. The Census Bureau recently updated the NAICS so that these firms are included in the Wired Telecommunications Carriers category[11] which is described as follows: "This industry comprises establishments primarily engaged in operating and/or providing access to transmission facilities and infrastructure that they own and/or lease for the transmission of voice, data, text, sound, and video using wired telecommunications networks. Transmission facilities may be based on a single technology or a combination of technologies. Establishments in this industry use the wired telecommunications network facilities that they operate to provide a variety of services, such as wired telephony services, including VoIP services; wired (cable) audio and video programming distribution; and wired broadband Internet services. By exception, establishments providing satellite television distribution services using facilities and infrastructure that they operate are included in this industry."[12] The SBA has updated the small business size standards to accord with the revised NAICS. The size standard for Wired Telecommunications Carriers is all firms having an average of 1,500 or fewer employees. The Census Bureau has not collected information on the size distribution of firms in the revised classification of Wired Telecommunications Carriers. Accordingly we will apply the new size standard to Census Bureau data for 2002 regarding the size distribution of Cable and Other Program Distribution.[13] There were a total of 1,191 firms in this category that operated for the entire year.[14] Of this total, 1,178 firms had fewer than 1,000 employees.[15] Thus, under this size standard, the majority of firms can be considered small.

Cable System Operators. The Communications Act of 1934, as amended, also contains a size standard for small cable system operators, which is "a cable operator that, directly or through an affiliate, serves in the aggregate fewer than 1 percent of all subscribers in the United States and is not affiliated with any entity or entities whose gross annual revenues in the aggregate exceed $250,000,000."[16] The Commission has determined that an operator serving fewer than 653,000 subscribers shall be deemed a small operator, if its annual revenues, when combined with the total annual revenues of all its affiliates,

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[8] 5 U.S.C. § 601(6).

[9] 5 U.S.C. § 601(3) (incorporating by reference the definition of "small-business concern" in the Small Business Act, 15 U.S.C. § 632). Pursuant to 5 U.S.C. § 601(3), the statutory definition of a small business applies "unless an agency, after consultation with the Office of Advocacy of the Small Business Administration and after opportunity for public comment, establishes one or more definitions of such term which are appropriate to the activities of the agency and publishes such definition(s) in the Federal Register."

[10] 15 U.S.C. § 632.

[11] 13 C.F.R. § 121.201 (2007), NAICS code 517110.

[12] U.S. Census Bureau, 2007 NAICS Definitions, 517110 Wired Telecommunications Carriers, http://www.census.gov/naics/2007/def/ND517110.HTM#N517110.

[13] 13 C.F.R. § 121.201 (2002), NAICS code 517510.

[14] U.S. Census Bureau, 2002 Economic Census, Subject Series: Information, Table 5, Receipts Size of Firms for the United States: 2002, NAICS code 517510 (issued November 2005).

[15] *Id.*

[16] 47 U.S.C. § 543(m)(2); *see* 47 C.F.R. § 76.901(f) & nn. 1-3.

do not exceed $250 million in the aggregate.[17] Industry data indicate that, of 994 cable operators nationwide, all but thirteen are small under this size standard.[18] We note that the Commission neither requests nor collects information on whether cable system operators are affiliated with entities whose gross annual revenues exceed $250 million,[19] and therefore we are unable to estimate more accurately the number of cable system operators that would qualify as small under this size standard.

Private Cable Operators (PCOs) also known as Satellite Master Antenna Television (SMATV) Systems. PCOs, also known as SMATV systems or private communication operators, are video distribution facilities that use closed transmission paths without using any public right-of-way. PCOs acquire video programming and distribute it via terrestrial wiring in urban and suburban multiple dwelling units such as apartments and condominiums, and commercial multiple tenant units such as hotels and office buildings. The SBA definition of small entities for Wired Telecommunications Carriers includes PCOs or SMATV systems and, thus, small entities are defined as all such companies with 1,500 or fewer employees.[20] Currently, there are approximately 76 members in the Independent Multi-Family Communications Council (IMCC), the trade association that represents PCOs.[21] Individual PCOs often serve approximately 3,000-4,000 subscribers, but the larger operations serve as many as 15,000-55,000 subscribers. In total, PCOs currently serve approximately 900,000 subscribers.[22] Because these operators are not rate regulated, they are not required to file employment data with the Commission. Furthermore, we are not aware of any privately published employment information regarding these operators. Based on the estimated number of operators and the estimated number of units served by the largest ten PCOs, we believe that a substantial number of PCO may qualify as small entities.

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

The new rule imposes a 30 percent limit on the number of MVPD subscribers nationwide that one person or entity may serve. No new reporting, recordkeeping or other compliance requirements are adopted.

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

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

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[17] 47 C.F.R. § 76.901(f); *see* Public Notice*, FCC Announces New Subscriber Count for the Definition of Small Cable Operator*, DA 01-158 (Cable Services Bureau, Jan. 24, 2001).

[18] These data are derived from: R.R. Bowker, *Broadcasting & Cable Yearbook 2007*, "Top 25 Cable/Satellite Operators," pages A-8 & C-2 (data current as of March 30, 2006); Warren Communications News, *Television & Cable Factbook 2007*, "Ownership of Cable Systems in the United States," pages D-1737 to D-1786.

[19] The Commission does receive such information on a case-by-case basis if a cable operator appeals a local franchise authority's finding that the operator does not qualify as a small cable operator pursuant to § 76.901(f) of the Commission's rules. *See* 47 C.F.R. § 76.909(b).

[20] 13 C.F.R. § 121.201 (2007), NAICS code 517110.

[21] For a list of IMCC members, see http://www.imcc-online.org/membership (visited Jan. 4, 2008).

[22] *See* Kagan Research, LLC, *Basic Cable Network Economics, 2005-2015,* Media Trends 2006, at 64.

entities."[23]

In this *Fourth Report and Order*, based on its calculations using an open field approach, the Commission sets a 30 percent horizontal ownership limit.[24] This rule limits the size of large MSOs and does not prevent small cable operators from growing larger. We also continue to base the limit on the number of actual MVPD subscribers, a figure used by cable operators when they negotiate with and purchase programming from video programmers. *See id*. Finally, the horizontal cap would not change pursuant to the Order. Accordingly, we do not find that the Order will impose new burdens on small cable operators.

The Commission considered other alternatives,[25] with respect to the horizontal limit, but the Order adopted a 30 percent horizontal ownership limit based on evidence that this is the level necessary to preserve programmer viability. The Commission believes that the decisions it adopts in the Order serve our public interest goals and comport with the evidence.

F. Report to Congress: The Commission will send a copy of the *Fourth Report and Order*, including this Supplemental FRFA, in a report to be sent to Congress pursuant to the Congressional Review Act.[26] In addition, the Commission will send a copy of the *Fourth Report and Order*, including this Supplemental FRFA, to the Chief Counsel for the advocacy of the SBA. A copy of the *Fourth Report and Order* and the Supplemental FRFA (or summaries thereof) will also be published in the Federal Register.[27]

[23] 5 U.S.C. § 603(c)(1) – (c)(4).

[24] *See Fourth Report & Order*, ¶¶ 40-73.

[25] *See e.g., Fourth Report & Order,* ¶¶ 77-83 (discussion of regional limits proposal).

[26] *See* 5 U.S.C. § 801(a)(1)(A).

[27] *See* 5 U.S.C. § 604(b).

APPENDIX D

SUPPLEMENTAL INITIAL REGULATORY FLEXIBILITY ANALYSIS

As required by the Regulatory Flexibility Act, as amended ("RFA")[1] the Commission has prepared this Supplemental Initial Regulatory Flexibility Analysis ("Supplemental IRFA") of the possible significant economic impact on a substantial number of small entities of the policies and rules considered in this *Further Notice of Proposed Rule Making* ("*Further Notice*"). Initial Regulatory Flexibility Analyses were included in the *2001 Further Notice of Proposed Rulemaking* ("*2001 Further Notice*") [2] and the *2005 Second Further Notice of Proposed Rulemaking* ("*2005 Second Further Notice*").[3] Written public comments are requested on this Supplemental IRFA. Comments must be identified as responses to the Supplemental IRFA and must be filed by the deadlines for comments on the *Second Further Notice*. The Commission will send a copy of the *Further Notice*, including this Supplemental IRFA, to the Chief Counsel for Advocacy of the Small Business Administration ("SBA").[4] In addition, the *Further Notice* and the Supplemental IRFA (or summaries thereof) will be published in the Federal Register.[5]

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

The attribution rules identify which interests in a media entity are counted for purposes of applying the broadcast and cable ownership rules. The *Further Notice* invites comment on (1) whether to retain the single majority shareholder attribution exemption in the cable and broadcast contexts; (2) whether, under the cable attribution rules, a limited partner may sell programming to the partnership and retain insulation; and (3) whether the Commission should clarify certain aspects of the cable Equity Debt ("ED") attribution rule. With respect to the first two issues, the Commission invites further comment on how to respond to the remand of the court in *Time Warner II*, which reversed, vacated, and remanded the Commission's decision to eliminate the single majority shareholder exemption and the Commission's prohibition of the sale of programming by an insulated limited partner to the partnership.[6]

Section 613(f) of the Communications Act requires the Commission to establish reasonable limits on the number of channels that can be occupied by the cable system's owned or attributed video programming services (vertical, or channel occupancy, limit). In *Time Warner II*, the D.C. Circuit remanded the Commission's channel occupancy limit.[7]

The Commission subsequently issued its *2001 Further Notice*, seeking comment on whether to reinstate the single majority shareholder exemption in the cable attribution rules, and whether to prohibit insulated limited partners from selling programming to their general partners. The Commission also sought comment aimed at establishing a sound record on which to fashion meaningful and relevant channel

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[1] *See* 5 U.S.C. § 603. The RFA, *see* 5 U.S.C. §§ 601-612, has been amended by the Contract With America Advancement Act of 1996, Pub. L. No. 104-121, 110 Stat. 847 (1996) ("CWAAA"). Title II of the CWAAA is the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA").

[2] *Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992,* Further Notice of Proposed Rulemaking, 16 FCC Rcd 17312 (2001) ("*2001 Further Notice").*

[3] *The Commission's Cable Horizontal and Vertical Ownership Limits*, Second Further Notice of Proposed Rulemaking, 20 FCC Rcd 9374, 9385 ¶ 17 (2005) ("*2005 Second Further Notice*").

[4] *See* 5 U.S.C. § 603(a).

[5] *See id*.

[6] *Time Warner Entertainment Co. v. FCC,* 240 F.3d 1126 (D.C. Cir. 2001) ("*Time Warner II*").

[7] *Id*. at 1139.

occupancy limits given the changes that have occurred in the MVPD industry.[8] While many commenters presented theoretical, legal, or economic arguments and anecdotal evidence, no party provided a compelling approach that supported a particular vertical limit. The Commission subsequently sought to augment the record by means of a programming network survey and econometric analysis, with limited results. In its *2005 Second Further Notice*, the Commission again sought to develop a more focused and useful record.

In this *Further Notice*, we seek additional comment on (1) whether to retain the single majority shareholder attribution exemption, which currently applies to the cable and broadcast ownership rules; (2) whether, under the cable attribution rules, a limited partner may sell programming to the partnership and retain insulation; and (3) whether the Commission should clarify the Equity Debt ("ED") provision in the cable attribution rules, to correspond with and reflect the guidance provided in the Commission's reconsideration of its broadcast attribution rules.[9] We also invite comment in the *Further Notice* on how to set a specific channel occupancy limit, responding to the remand of the court in *Time Warner II*. We issue this Supplemental IRFA in order to invite comment on the effects on small entities of the proposals identified in this *Further Notice*. We particularly solicit comment from all small business entities, including minority-owned and women-owned small businesses.

B. Basis

The *Further Notice* is adopted pursuant to sections 2(a), 4(i), 303, 307, 309, 310, and 613 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 152(a), 154(i), 303, 307, 309, 310, and 533.

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

The RFA directs agencies to provide a description of, and, where feasible, an estimate of the number of small entities that may be affected by the proposed rules, if adopted.[10] The RFA defines the term "small entity" as having the same meaning as the terms "small business," "small organization," and "small governmental entity" under Section 3 of the Small Business Act.[11] In addition, the term "small business" has the same meaning as the term "small business concern" under the Small Business Act.[12] A small business concern is one which: (1) is independently owned and operated; (2) is not dominant in its field of operation; and (3) satisfies any additional criteria established by the SBA.[13]

Television Broadcasting. In this context, the application of the statutory definition to television stations is of concern. The Small Business Administration defines a television broadcasting station that has no more than $13 million in annual receipts as a small business.[14] Business concerns included in this

[8] *2001 Further Notice*, 16 FCC Rcd at 17350-51 ¶ 81.

[9] *1999 Broadcast Attribution Reconsideration Order,* 16 FCC Rcd at 1110-15 ¶¶ 25-39.

[10] 5 U.S.C. § 603(b)(3).

[11] *Id*. § 601(3) (incorporating by reference the definition of "small business concern" in 15 U.S.C. § 632). Pursuant to the RFA, the statutory definition of a small business applies, "unless an agency, after consultation with the Office of Advocacy of the SBA and after opportunity for public comment, establishes one or more definitions of the term where appropriate to the activities of the agency and publishes the definition(s) in the Federal Register."

[12] *Id.*

[13] 15 U.S.C. § 632.

[14] 13 C.F.R. § 121.201 (2007), NAICS Code 515120.

industry are those "primarily engaged in broadcasting images together with sound."[15] According to Commission staff review of the BIA Financial Network, Inc. Media Access Pro Television Database as of December 7, 2007, about 825 (66 percent) of the 1,250 commercial television stations in the United States have revenues of $13 million or less.[16] However, in assessing whether a business entity qualifies as small under the above definition, business control affiliations[17] must be included. Our estimate, therefore, likely overstates the number of small entities that might be affected by any changes to the attribution rules, because the revenue figures on which this estimate is based do not include or aggregate revenues from affiliated companies.

An element of the definition of "small business" is that the entity not be dominant in its field of operation. The Commission is unable at this time and in this context to define or quantify the criteria that would establish whether a specific television station is dominant in its market of operation. Accordingly, the foregoing estimate of small businesses to which the rules may apply does not exclude any television stations from the definition of a small business on this basis and is therefore over-inclusive to that extent. An additional element of the definition of "small business" is that the entity must be independently owned and operated. It is difficult at times to assess these criteria in the context of media entities, and our estimates of small businesses to which they apply may be over-inclusive to this extent.

Radio Broadcasting. The Small Business Administration defines a radio broadcasting entity that has $6.5 million or less in annual receipts as a small business.[18] Business concerns included in this industry are those "primarily engaged in broadcasting aural programs by radio to the public."[19] According to Commission staff review of the BIA Financial Network, Inc. Media Access Radio Analyzer Database as of December 7, 2007, about 10,500 (95 percent) of 11,050 commercial radio stations in the United States have revenues of $6.5 million or less. We note, however, that in assessing whether a business entity qualifies as small under the above definition, business control affiliations[20] must be included. Our estimate, therefore, likely overstates the number of small entities that might be affected by any changes to the ownership rules, because the revenue figures on which this estimate is based do not include or aggregate revenues from affiliated companies.

In this context, the application of the statutory definition to radio stations is of concern. An element of the definition of "small business" is that the entity not be dominant in its field of operation. We are unable at this time and in this context to define or quantify the criteria that would establish whether a specific radio station is dominant in its field of operation. Accordingly, the foregoing estimate of small

[15] OMB, North American Industry Classification System: United States, 1997, at 508-09 (1997) (NAICS Code 51320 which was changed to 51520 in October 2002). This category description continues, "These establishments also produce or transmit visual programming to affiliated broadcast television stations, which in turn broadcast the programs to the public on a predetermined schedule. Programming may originate in their own studio, from an affiliated network, or from external sources." Separate census categories pertain to businesses primarily engaged in produced programming. *See id.* at 502-505, NAICS Code 512110. Motion Picture and Video Production; Code 512120, Motion Picture and Video Distribution, Code 512191, 19 FCC Rcd 15238 (2004). Teleproduction and Other Post-Production Services, and Code 512199, Other Motion Picture and Video Industries.

[16] 13 C.F.R. § 121.201, NAICS code 517510.

[17] "[Business concerns] are affiliates of each other when one business concern controls or has the power to control the other or a third party or parties controls or has the power to control both." 13 C.F.R. § 121.103(a)(1).

[18] *See* NAICS Code 515112.

[19] *Id.*

[20] "[Business concerns] are affiliates of each other when one business concern controls or has the power to control the other or a third party or parties controls or has the power to control both." 13 C.F.R. § 121.103(a)(1).

businesses to which the rules may apply does not exclude any radio station from the definition of a small business on this basis and is therefore over-inclusive to that extent. An additional element of the definition of "small business" is that the entity must be independently owned and operated. We note that it is difficult at times to assess these criteria in the context of media entities, and our estimates of small businesses to which they apply may be over-inclusive to this extent.

Cable and Other Program Distribution. The Census Bureau recently updated the NAICS and these firms are included in the Wired Telecommunications Carriers category,[21] described as: "This industry comprises establishments primarily engaged in operating and/or providing access to transmission facilities and infrastructure that they own and/or lease for the transmission of voice, data, text, sound, and video using wired telecommunications networks. Transmission facilities may be based on a single technology or a combination of technologies. Establishments in this industry use the wired telecommunications network facilities that they operate to provide a variety of services, such as wired telephony services, including VoIP services; wired (cable) audio and video programming distribution; and wired broadband Internet services. By exception, establishments providing satellite television distribution services using facilities and infrastructure that they operate are included in this industry."[22] The SBA has updated the small business size standards to accord with the revised NAICS. The size standard for Wired Telecommunications Carriers is all firms having an average of 1,500 or fewer employees.[23] The Census Bureau has not collected information on the size distribution of firms in the revised classification of Wired Telecommunications Carriers. Accordingly we will apply the new size standard to Census Bureau data for 2002 regarding the size distribution of Cable and Other Program Distribution.[24] There were a total of 1,191 firms in this category that operated for the entire year.[25] Of this total, 1,178 firms had fewer than 1,000 employees.[26] Thus, under this size standard, the majority of firms can be considered small.

Cable Companies and Systems. The Commission has also developed its own small business size standards, for the purpose of cable rate regulation. Under the Commission's rules, a "small cable company" is one serving 400,000 or fewer subscribers, nationwide.[27] Industry data indicate that, of 994 cable operators nationwide, all but thirteen are small under this size standard.[28] In addition, under the Commission's rules, a "small system" is a cable system serving 15,000 or fewer subscribers.[29] Industry data indicate that, of 6,391 systems nationwide, 5,399 systems have under 10,000 subscribers, and an

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[21] 13 C.F.R. § 121.201 (2007), NAICS code 517110

[22] U.S. Census Bureau, 2007 NAICS Definitions, 517110 Wired Telecommunications Carriers, http://www.census.gov/naics/2007/def/ND517110.HTM#N517110.

[23] 13 C.F.R. § 121.201 (2007), NAICS code 517110.

[24] 13 C.F.R. § 121.201 (2002), NAICS code 517510.

[25] U.S. Census Bureau, 2002 Economic Census, Subject Series: Information, Table 5, Receipts Size of Firms for the United States: 2002, NAICS code 517510 (issued November 2005).

[26] *Id.*

[27] 47 C.F.R. § 76.901(e). The Commission determined that this size standard equates approximately to a size standard of $100 million or less in annual revenues. *Implementation of Sections of the 1992 Cable Act: Rate Regulation,* Sixth Report and Order and Eleventh Order on Reconsideration, 10 FCC Rcd 7393, 7408 (1995).

[28] These data are derived from: R.R. Bowker, *Broadcasting & Cable Yearbook 2007*, "Top 25 Cable/Satellite Operators," pages A-8 & C-2 (data current as of March 30, 2006); Warren Communications News, *Television & Cable Factbook 2007*, "Ownership of Cable Systems in the United States," pages D-1737 to D-1786.

[29] 47 C.F.R. § 76.901(c).

additional 352 systems have 10,000-19,999 subscribers.[30] Thus, under this second size standard, most cable systems are small.

Cable System Operators. The Communications Act of 1934, as amended, also contains a size standard for small cable system operators, which is "a cable operator that, directly or through an affiliate, serves in the aggregate fewer than 1 percent of all subscribers in the United States and is not affiliated with any entity or entities whose gross annual revenues in the aggregate exceed $250,000,000."[31] The Commission has determined that an operator serving fewer than 653,000 subscribers shall be deemed a small operator, if its annual revenues, when combined with the total annual revenues of all its affiliates, do not exceed $250 million in the aggregate.[32] Industry data indicate that, of 994 cable operators nationwide, all but thirteen are small under this size standard.[33] We note that the Commission neither requests nor collects information on whether cable system operators are affiliated with entities whose gross annual revenues exceed $250 million,[34] and therefore we are unable to estimate more accurately the number of cable system operators that would qualify as small under this size standard.

Private Cable Operators (PCOs) also known as Satellite Master Antenna Television (SMATV) Systems. PCOs, also known as SMATV systems or private communication operators, are video distribution facilities that use closed transmission paths without using any public right-of-way. PCOs acquire video programming and distribute it via terrestrial wiring in urban and suburban multiple dwelling units such as apartments and condominiums, and commercial multiple tenant units such as hotels and office buildings. The SBA definition of small entities for Wired Telecommunications Carriers includes PCOs or SMATV systems and, thus, small entities are defined as all such companies with 1,500 or fewer employees.[35] Currently, there are approximately 76 members in the Independent Multi-Family Communications Council (IMCC), the trade association that represents PCOs.[36] Individual PCOs often serve approximately 3,000-4,000 subscribers, but the larger operations serve as many as 15,000-55,000 subscribers. In total, PCOs currently serve approximately 1.1 million subscribers.[37] Because these operators are not rate regulated, they are not required to file employment data with the Commission. Furthermore, we are not aware of any privately published employment information regarding these operators. Based on the estimated number of operators and the estimated number of units served by the largest ten PCOs, we believe that a substantial number of PCO may qualify as small entities.

Home Satellite Dish ("HSD") Service. Because HSD provides subscription services, HSD falls within

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[30] Warren Communications News, *Television & Cable Factbook 2007*, "U.S. Cable Systems by Subscriber Size," page F-2 (data current as of Oct. 2006). The data do not include 699 systems for which classifying data were not available.

[31] 47 U.S.C. § 543(m)(2); *see* 47 C.F.R. § 76.901(f) & nn. 1-3.

[32] 47 C.F.R. § 76.901(f); *see* Public Notice*, FCC Announces New Subscriber Count for the Definition of Small Cable Operator*, DA 01-158 (Cable Services Bureau, Jan. 24, 2001).

[33] These data are derived from: R.R. Bowker, *Broadcasting & Cable Yearbook 2007*, "Top 25 Cable/Satellite Operators," pages A-8 & C-2 (data current as of March 30, 2006); Warren Communications News, *Television & Cable Factbook 2007*, "Ownership of Cable Systems in the United States," pages D-1737 to D-1786.

[34] The Commission does receive such information on a case-by-case basis if a cable operator appeals a local franchise authority's finding that the operator does not qualify as a small cable operator pursuant to § 76.901(f) of the Commission's rules. *See* 47 C.F.R. § 76.909(b).

[35] 13 C.F.R. § 121.201 (2007), NAICS code 517110.

[36] For a list of IMCC members, see http://www.imcc-online.org.membership (visited Jan. 4, 2008).

[37] Kagan Research, LLC, *Basic Cable Network Economics, 2005-2015,* Media Trends 2006, at 64.

the SBA-recognized definition of Wired Telecommunications Carriers, which includes all such companies with 1,500 or fewer employees.[38] HSD or the large dish segment of the satellite industry is the original satellite-to-home service offered to consumers, and involves the home reception of signals transmitted by satellites operating generally in the C-band frequency. Unlike DBS, which uses small dishes, HSD antennas are between four and eight feet in diameter and can receive a wide range of unscrambled (free) programming and scrambled programming purchased from program packagers that are licensed to facilitate subscribers' receipt of video programming. There are approximately 30 satellites operating in the C-band, which carry over 500 channels of programming combined; approximately 350 channels are available free of charge and 150 are scrambled and require a subscription. HSD is difficult to quantify in terms of employment. HSD owners have access to program channels placed on C-band satellites by programmers for receipt and distribution by MVPDs. In January 2007, there were 68,781 households authorized to receive HSD service.[39] The Commission has no information regarding the number of employees for the four C-Band distributors.

Wireless Cable Systems. Wireless cable systems use the Broadband Radio Service ("BRS")[40] and Educational Broadband Service ("EBS")[41] frequencies in the 2 GHz band to transmit video programming and provide broadband services to subscribers. The Census Bureau recently updated the NAICS and these firms are now included in the Wireless Telecommunications Carriers (except Satellite) category,[42] described as: "This industry comprises establishments engaged in operating and maintaining switching and transmission facilities to provide communications via the airwaves. Establishments in this industry have spectrum licenses and provide services using that spectrum, such as cellular phone services, paging services, wireless Internet access, and wireless video services."[43] The SBA has updated the small business size standards to accord with the revised NAICS and, for Wireless Telecommunications Carriers (except Satellite), the standard is all firms having an average of 1,500 or fewer employees.[44]

The Commission has also defined small BRS entities in the context of Commission license auctions. In the 1996 BRS (MMDS) auction,[45] the Commission defined a small business as an entity that had annual average gross revenues of less than $40 million in the previous three calendar years.[46] This definition of

[38] 13 C.F.R. § 121.201 (2007), NAICS code 517110.

[39] *C*-Band, SKYREPORT, Feb. 12. 19, 2006 at 4 and *C-Band Numbers Keep Dwindling,* Satellite Business News FAXUpdate, July 7, 2006. These numbers are based on a report from Motorola's Access Control Center, which oversees authorizations and de-authorizations of satellite receivers using Motorola's proprietary conditional access systems.

[40] Broadband Radio Service ("BRS"), formerly known as Multipoint Distribution Service ("MDS") or Multichannel Multipoint Distribution Service ("MMDS"), is regulated by Part 27 of the Commission's rules; *see* 47 C.F.R. Part 27.

[41] Educational Broadband Service ("EBS"), formerly known as Instructional Television Fixed Service ("ITFS"), is regulated by Part 27 of the Commission's rules; *see* 47 C.F.R. Part 27. EBS licensees, however, are permitted to lease spectrum for BRS operation.

[42] 13 C.F.R. § 121.201 (2007), NAICS code 517210.

[43] U.S. Census Bureau, 2007 NAICS Definitions, 517110 Wireless Telecommunications Carriers (except Satellite), http://www.census.gov/naics/2007/def/ND517210.HTM#N517210.

[44] 13 C.F.R. § 121.201 (2007), NAICS code 517210.

[45] MDS Auction No. 6 began on November 13, 1995, and closed on March 28, 1996. (67 bidders won 493 licenses.) Multipoint Distribution Service ("MDS"), also known as Multichannel Multipoint Distribution Service ("MMDS"), is now known as Broadband Radio Service ("BRS").

[46] 47 C.F.R. § 21.961(b)(1).

a small entity in the context of MDS auctions was approved by the SBA.[47] In the 1996 auction, 67 bidders won 493 licenses. Of the 67 auction winners, 61 claimed status as a small business. At this time, the Commission estimates that of the 61 small business 1996 auction winners, 48 remain small business licensees. Specifically, the Commission estimates that some of the EBS licensees are small businesses since there are currently 2,032 EBS licensees, and all but 100 of these licenses are held by educational institutions.[48] In addition to the 48 small businesses that hold BTA authorizations, there are also approximately 392 incumbent BRS licensees that have gross revenues that are not more than $40 million and are thus considered small entities.[49]

Although the SBA changed the small business definition in 2007 so that BRS and EBS now fall under Wireless Telecommunications Carriers (except Satellite), we lack the data to estimate how many entities will be affected by the regulation. Therefore, we continue to employ the definition for small businesses used in the 1996 auction, and estimate that the majority of the affected entities are small.

Open Video Systems ("OVS"). The OVS framework provides opportunities for the distribution of video programming other than through cable systems. Because OVS operators provide subscription services,[50] OVS falls within the SBA-recognized definition of Wired Telecommunications Carriers, which provides that a small entity is one with 1,500 or fewer employees.[51] The Commission has certified 25 OVS operators, with some now providing service. Broadband service providers (BSPs) are currently the only significant holders of OVS certifications or local OVS franchises, even though OVS is one of four statutorily-recognized options for local exchange carriers (LECs) to offer video programming services.[52] As of June 2007, BSPs served approximately 1.4 million subscribers, representing 1.46 percent of all MVPD households.[53] Among BSPs, however, those operating under the OVS framework are in the minority, with approximately eight percent operating with an OVS certification.[54] BSPs include companies such as RCN, Champion Broadband, Knology, and SureWest Communications.[55] RCN received approval to operate OVS systems in New York City, Boston, Washington, D.C. and other areas. The Commission does not have employment information regarding the entities authorized to provide OVS, some of which may not yet be operational. We thus believe that at least some of the OVS

[47] *See ITFS Order*, 10 FCC Rcd at 9589.

[48] In addition, the term "small entity" under SBREFA applies to small organizations (nonprofits) and to small governmental jurisdictions (cities, counties, towns, townships, villages, school districts, and special districts with populations of less than 50,000). 5 U.S.C. §§ 601(4)-(6). We do not collect annual revenue data on EBS licensees.

[49] 47 U.S.C. § 309(j). Hundreds of stations were licensed to incumbent BRS licensees prior to implementation of Section 309(j) of the Communications Act of 1934, 47 U.S.C. § 309(j). For these pre-auction licenses, the applicable standard is SBA's small business size standards for "other telecommunications" (annual receipts of $12.5 million or less). *See* 13 C.F.R. § 121.201, NAICS code 517910.

[50] *See* 47 U.S.C. § 573.

[51] 13 C.F.R. § 121.201 (2007), NAICS code 517110.

[52] For a complete list of OVS certifications, *see* Current Filings For Certification of Open Video Systems, at http://www.fcc.gov/mb/ovs/csovscer.html (visited Jan. 4, 2008).

[53] BSP subscribers: 2003 subscribers from NCTA Comments for the *2003 Report* at 8; 2004 subscribers from BSPA Comments at 6 for the *2004 Report* and Commission estimates; 2005 from *2005 Report*, 21 FCC Rcd at 2617; 2006 subscribers from BSPA Comments at 6 and Commission estimates.

[54] *See 2005 Cable Competition Report*, 20 FCC Rcd at 2802, ¶ 71.

[55] As of June 2007, RCN serves 355,000 subscribers and Knology serves 221,800 subscribers. *See* http://www.ncta.com/Statistic/Statistic/Top25MSOs.aspx (visited Jan. 4, 2008).

operators may qualify as small entities.

Cable and Other Subscription Programming. The Census Bureau defines this category as follows: "This industry comprises establishments primarily engaged in operating studios and facilities for the broadcasting of programs on a subscription or fee basis . . . . These establishments produce programming in their own facilities or acquire programming from external sources. The programming material is usually delivered to a third party, such as cable systems or direct-to-home satellite systems, for transmission to viewers."[56] The SBA has developed a small business size standard for firms within this category, which is: firms with $13.5 million or less in annual receipts.[57] According to Census Bureau data for 2002, there were 270 firms in this category that operated for the entire year.[58] Of this total, 217 firms had annual receipts of under $10 million and 13 firms had annual receipts of $10 million to $24,999,999.[59] Thus, under this category and associated small business size standard, the majority of firms can be considered small.

A "small business" under the RFA is one that, *inter alia*, meets the pertinent small business size standard (*e.g.*, a telephone communications business having 1,500 or fewer employees), and "is not dominant in its field of operation."[60] The SBA's Office of Advocacy contends that, for RFA purposes, small incumbent local exchange carriers are not dominant in their field of operation because any such dominance is not "national" in scope.[61]

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

Depending on the rules adopted as a result of this *Further Notice*, the Report and Order ultimately adopted in this proceeding may contain new or modified information collections. We anticipate that none of the changes would result in an increase to the reporting and recordkeeping requirements of broadcast stations, newspapers, or applicants for licenses. As noted above, we invite small business entities to comment in response to this *Further Notice*.

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

The RFA requires an agency to describe any significant alternatives that it has considered in reaching its proposed approach, which may include the following four alternatives (among others): (1) the establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (2) the clarification, consolidation, or simplification of compliance or reporting requirements under the rule for small entities; (3) the use of performance, rather than design,

[56] U.S. Census Bureau, 2002 NAICS Definitions, "515210 Cable and Other subscription Programming"; http://www.census.gov/epcd/naics02/def/ND515210.HTM#N515210.

[57] 13 C.F.R. § 121.201 (2007), NAICS code 515210.

[58] U.S. Census Bureau, 2002 Economic Census, Subject Series: Information, "Establishment and Firm Size (Including Legal Form of Organization)," Table 4, NAICS code 515210 (issued Nov. 2005). As noted above, the U.S. Census Bureau has not yet collected data for 2007, so we continue to rely on 2002 data.

[59] *Id*. An additional 40 firms had annual receipts of $25 million or more.

[60] 15 U.S.C. § 632.

[61] Letter from Jere W. Glover, Chief Counsel for Advocacy, SBA, to William E. Kennard, Chairman, FCC (May 27, 1999). The Small Business Act contains a definition of "small-business concern," which the RFA incorporates into its own definition of "small business." *See* 15 U.S.C. § 632(a) (Small Business Act); 5 U.S.C. § 601(3) (RFA). SBA regulations interpret "small business concern" to include the concept of dominance on a national basis. *See* 13 C.F.R. § 121.102(b).

standards; and (4) an exemption from coverage of the rule, or any part thereof, for small entities.[62]

We are directed under law to describe any alternatives we consider, including alternatives not explicitly listed above.[63] The *Further Notice* seeks comment on whether or not it should retain the single majority shareholder exemption, and whether eliminating the exemption would negatively impact capital investment, particularly in small businesses. Additionally, it seeks comment on whether or not to bar a limited partner from selling video programming to the general partner cable entity in order to maintain insulated limited partner status for purposes of the attribution rules. It also seeks comment on whether to conform various aspects of the ED cable attribution rule to the amended EDP broadcast attribution rule upon which the cable rule was based.[64] Finally, it seeks comment on how it should craft a rule to limit the number of cable channels that can be occupied by affiliated video programming services. Cable ownership limits are intended to prevent large cable entities from unfairly impeding the flow of video programming to consumers through their horizontal reach or their level of vertical integration. We anticipate that any channel occupancy limits adopted by the Commission will have little adverse impact on small cable entities because small entities as a general matter do not approach the channel occupancy limits and are not the focus of the rule. We also expect that, whichever alternatives are chosen with respect to revising the cable attribution rules, the Commission will seek to minimize any adverse effects on small businesses.

F. Federal Rules that May Duplicate, Overlap, or Conflict with the Proposed Rules

None.

[62] 5 U.S.C. § 603(c).

[63] 5 U.S.C. § 603(b).

[64] The Equity Plus Debt (ED) rule attributes the interest of those who hold 33 percent or more of a cable entity's total assets, including interests which otherwise would not be attributable (including non-voting stock and insulated partnership interests).

APPENDIX E

TECHNICAL APPENDIX

A. Estimating the Penetration Rate

1. We estimate the penetration rate as the fraction of a cable operator's subscribers that will have access to a network if the operator reaches a carriage agreement with the network. Two elements play a role in this penetration rate. An operator, once having reached an agreement with a network, may not carry the network on all of the systems the operator controls. Furthermore, even when the network is available on a cable system, the network may be placed on a tier which is not purchased by all of the system's subscribers. We use confidential data from the Commission's Cable Price Survey to determine the subscriber penetration rate of 135 cable networks. The launch date of each network is used to calculate the age of each network.[1] With this information it is possible to predict the fraction of a cable operator's subscribers a programming network is likely to have access to at any point in its lifecycle. We limit our analysis to cable networks that are standard definition, predominately English language, nationally distributed, and are not generally sold on an a la carte basis. These requirements yield the 135 cable networks in the analysis.

2. Due to the small number of programming networks in any single age category, we use linear regression to develop a more robust estimate of the relationship between the subscriber penetration rate and the age of a network. We explore several specifications of the relationship between the age of a network and the network's subscriber penetration rate. We consider, in succession, the addition of higher level polynomials of the age variable in the regression, up through inclusion of age to the fourth power. The regression result when only age is included in the analysis are:

Regression Specification 1			
Independent Variable	**Coefficient**	**Robust Standard Error**	**t-Statistic**
Constant	0.1775261	0.0325708	5.45
Age	0.0243273	0.0025334	9.60
$R^2 = 0.398$			

Both the constant and the coefficient on age are statistically different from zero in this result. The result generates an estimate of the penetration rate of a network five years after launch of 29.92%. However, this expression also predicts that the penetration rate of a network that has been in existence for 35 years would have a predicted penetration rate of 105%. While the oldest network in our data is 33 years old, this is still a drawback to using this simple specification. Therefore it is best to incorporate additional polynomial terms to better fit the data.

[1] *12th Annual Video Competition Report*, 21 FCC Rcd at 2622-43, Tables C-1 and C-2.

3. The next specification includes age and age raised to the second power, with the following results:

Regression Specification 2			
Independent Variable	**Coefficient**	**Robust Standard Error**	**t-Statistic**
Constant	0.0489173	0.0500314	0.98
Age	0.0492842	0.0099937	4.93
Age^2	-.0008458	-0.0003409	-2.48
$R^2 = 0.430$			

The coefficients on the age variables are statistically different from zero; however, the estimated constant is not. This is not a cause for concern since we would expect a network less than one year old to have a relatively low penetration rate. This result generates an estimate of the penetration rate of 27.42% for a network five years after launch. The result also yields coefficients that ensure that no network, regardless of its age, has a penetration rate above 100%. Furthermore, the regression yields a reasonable increase in the value of R^2, which represents the fraction of the variation in the data that is explained by the regression.

4. The next specification adds age raised to the third power to the previous specification and yields the following results:

Regression Specification 3			
Independent Variable	**Coefficient**	**Robust Standard Error**	**t-Statistic**
Constant	0.1080096	0.0563045	1.92
Age	0.0283781	0.0183821	1.54
Age^2	0.0009049	0.0015611	0.58
Age^3	-0.0000393	0.0000367	-1.07
$R^2 = 0.435$			

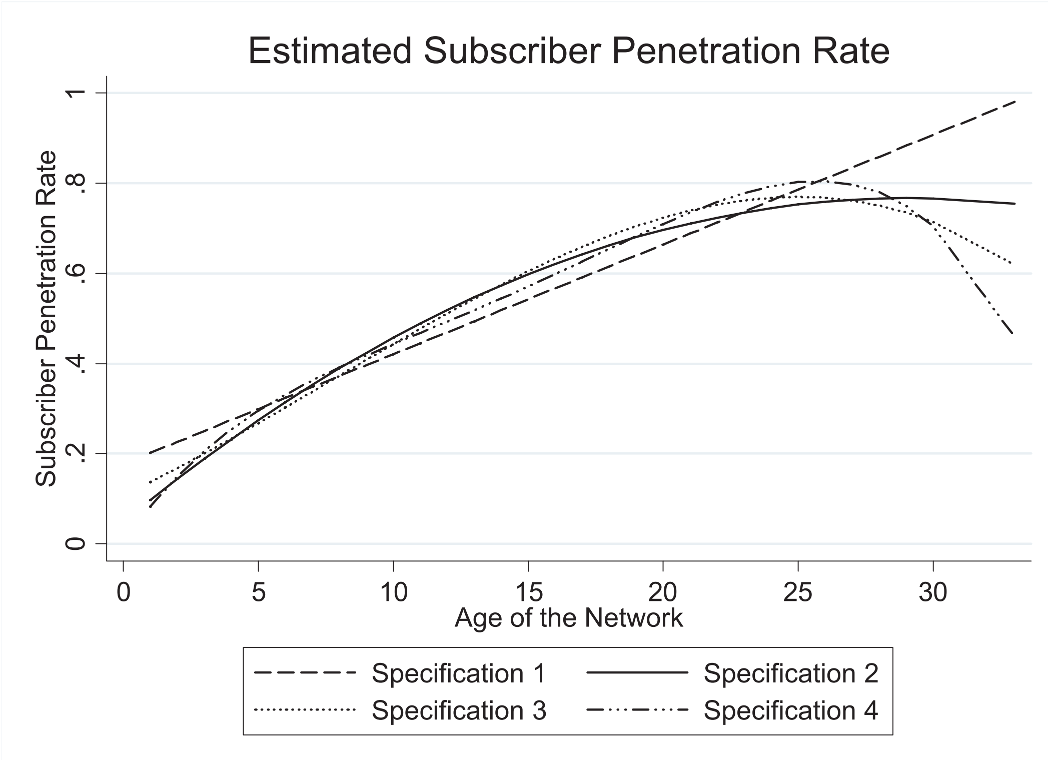
This result generates an estimate of the penetration rate of 26.76% for a network five years after launch. The result also yields coefficients that ensure that no network, regardless of its age, has a penetration rate above 100%. The increase in the value of R^2 is much less pronounced when adding the cubic term of age. Furthermore, all of the estimated coefficients are individually not statistically different from zero, though this is likely due to the high degree of correlation between the polynomial terms rather than the likelihood that there is no relationship between the age of the network and its penetration rate. This is reinforced by an F-test, which tests whether all of the estimated coefficients, except the constant, are zero. This hypothesis is soundly rejected with a test statistic of 51 distributed with (3, 131) degrees of freedom.

5. The final specification adds age raised to the fourth power to the previous specification and yields the following re results:

Regression Specification 4			
Independent Variable	**Coefficient**	**Robust Standard Error**	**t-Statistic**
Constant	0.0048196	0.0709284	0.07
Age	0.0847567	0.0359461	2.36
Age^2	-0.0068894	0.0049475	-1.39
Age^3	0.0003392	0.0002325	1.46
Age^4	-0.0000059	0.0000035	-1.69
$R^2 = 0.443$			

This result generates an estimate of the penetration rate of 29.51% for a network five years after launch. The result also yields coefficients that ensure that no network, regardless of its age, has a penetration rate above 100%. The increase in the value of R^2 is a bit more pronounced when adding the additional term, though it provides less of a lift than adding the squared value of age in specification 2. All of the estimated coefficients, with the exception of the coefficient on age, are not statistically different from zero. As with the previous specification, this is likely due to the high degree of correlation between the polynomial terms rather than the lack of higher order polynomial effects in the relationship between the age of the network and its penetration rate. An F-test rejects the hypothesis that all of the estimated coefficients except the constant are zero.

6. We will use regression specification 2 to determine the appropriate penetration rate for use in the open field analysis. This specification strikes a balance between statistical significance and explanatory power as measured by the R^2 value. The following diagram shows the estimated profile of penetration over the lifetime of the network. Most of the differences in the specifications occur in older networks. There is little variation in estimated penetration rates at five years among the four specifications.



B. The Subscriber Penetration Rates from the Cable Price Survey

7. We use confidential data from the Commission's Cable Price Survey to estimate the likely penetration of a programming network given its age. The Cable Price Survey sampled 783 cable community units as of January 1, 2006. For each franchise, the respondent provides a list of the programming networks that are carried, the tier on which each network is carried, and the number of subscribers to the tier.[2] By aggregating all of this information to the level of a cable operator, we calculate the fraction of each cable operator's subscribers who have access to a specific programming network. The penetration rate of a network on the surveyed cable operator's systems is then averaged with the penetration rate of the network among the other surveyed cable operators that carry the network on at least one system to obtain an estimate of the network's penetration rate nationwide among those operators that carry the network. The resulting penetration rates for the 135 networks in the analysis are presented in the following table.[3]

Network	Year of Launch	Penetration
ABC Family	1977	85.2%
American Movie Classics	1984	84.1%
AmericanLife TV	1985	17.8%
America's Store	1986	13.3%
Animal Planet	1996	85.9%

[2] The survey contains information on the basic, expanded basic, and most popular digital tier.

[3] The data in this table were derived from the responses to the Cable Price Survey. Although individual responses are subject to confidentiality requests, the table presents aggregated data.

Anime Network	2002	0.8%
Arts & Entertainment	1984	87.0%
AZN	1990	19.8%
BBC America	1998	41.6%
BET	1980	79.8%
BET Gospel	2002	1.8%
BET Jazz	1996	33.2%
Biography Channel	1998	40.5%
Black Family Channel	1999	22.4%
Bloomberg Television	1995	31.2%
Boomerang	2000	14.2%
Bravo	1980	79.9%
Bridges TV	2004	1.4%
Cartoon Network	1992	85.9%
Celtic Vision	1995	1.8%
Church Channel	2002	0.5%
CNBC	1989	86.2%
CNBC World	1989	13.9%
CNN	1980	86.8%
CNN Headline News	1982	87.0%
CNN International	1995	9.2%
College Sports Television	2003	20.2%
Comedy Central	1991	86.0%
Country Music TV	1983	75.8%
Court TV	1991	83.2%
C-SPAN	1979	86.9%
C-SPAN2	1986	79.8%
C-SPAN3	1997	23.6%
Current	2005	18.1%
DayStar Television	1998	6.1%
Discovery Channel	1985	87.8%
Discovery Health	1998	45.3%
Discovery Home & Leisure	1996	41.9%
Discovery Kids	1996	44.5%
Discovery Science	1996	44.6%
Discovery Times	1996	44.6%
Disney Network	1983	85.1%
Do-It-Yourself	1994	36.9%
E! Entertainment Television	1990	85.5%
ESPN	1979	87.3%
ESPN Classics	1995	55.3%
ESPN2	1993	87.3%
ESPNews	1996	44.6%
ESPNU	2005	3.3%
EWTN	1981	57.7%
FamilyNet	2000	7.9%
Fine Living	2002	32.9%
FIT TV	2004	39.4%
Food Network	1993	85.9%
Fox Movie Channel	1994	34.6%
Fox News Channel	1996	86.5%
Fox Reality Channel	2005	4.2%

Fox Soccer Channel	1997	45.0%
FUEL	2003	19.6%
FUSE	1994	37.7%
FX	1994	85.9%
G4/TechTV	2002	55.3%
Game Show Network	1994	54.4%
Golf Channel	1995	73.8%
Great American Country	1995	39.3%
Hallmark Channel	1998	64.1%
Hallmark Movie Channel	2004	6.8%
History Channel	1995	87.7%
History Channel International	2004	38.5%
Home and Garden TV	1994	86.4%
Home Shopping Network	1985	83.4%
Horse Racing TV	2002	3.7%
Independent Film Channel	1994	33.9%
Inspirational Life	1998	18.8%
Inspirational Network	1990	29.0%
JCTV	2002	0.2%
Jewelry Channel	1993	22.4%
Learning Channel	1980	87.8%
Lifetime	1984	87.1%
Lifetime Movie Network	1998	47.2%
Lifetime Real Women	2001	13.3%
LOGO	2005	20.3%
Military Channel	1998	42.5%
MSNBC	1996	81.4%
MTV	1981	87.6%
MTV Hits	2002	34.5%
MTV Jams	2002	23.7%
MTV2	1998	56.8%
NASA	1991	7.0%
National Geographic Channel	2001	56.0%
NBA TV	1999	36.7%
NFL Network	2003	23.1%
Nick Too	1998	25.7%
Nickelodeon	1979	87.4%
Nickelodeon Gas	1999	43.5%
Nicktoons	1999	40.0%
NOGGIN	1999	44.7%
Outdoor Channel	1993	34.2%
Outdoor Life Network	1995	65.5%
Ovation	1996	15.4%
Oxygen	2000	60.6%
PBS Kids Sprout	2005	15.2%
Product Information Network	1994	8.5%
QVC	1986	85.3%
Sci-Fi Channel	1992	83.5%
Shop at Home	1986	14.5%
Shop NBC	1991	50.3%
SoapNet	2000	39.6%
Speed Channel	1996	67.0%

Spike	1983	87.1%
Sportsman Channel	2003	3.3%
Style	1998	58.5%
Sundance	1996	42.2%
TBS	1976	82.9%
Tennis Channel	2003	24.6%
TNT	1988	85.1%
Toon Disney	1998	48.1%
Travel Channel	1987	80.6%
Trinity Broadcast Network	1973	34.5%
Turner Classic Movies	1994	69.1%
TV Games Network	1994	11.4%
TV Guide Channel	1988	65.4%
TV Land	1996	83.2%
TV One	2004	20.1%
USA Network	1980	86.8%
VH1	1985	87.3%
VH1 Classic	2000	44.0%
VH1 Country	1998	27.6%
VH1 Soul	1998	25.6%
WE: Women's Entertainment	1997	52.1%
Weather Channel	1982	86.5%
Weatherscan	1999	17.2%
WGN Superstation	1978	48.2%
Wisdom	1997	4.5%
Word Network	2000	17.5%

STATEMENT OF
CHAIRMAN KEVIN J. MARTIN

Re: *The Commission's Cable Horizontal and Vertical Ownership Limits*; *Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992*; *Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996*; *Review of the Commission's Regulations Governing Attribution of Broadcast and Cable/MDS Interests*; *Review of the Commission's Regulations and Policies Affecting Investment in the Broadcast Industry*; *Reexamination of the Commission's Cross-Interest Policy*.

I pleased that today the Commission takes action on an issue that is long overdue. In September 2001, at only my second Open Meeting as a Commissioner, we adopted a notice seeking comment on this issue. More than six years later, we finally adopt an order.

In 1992, Congress instructed the FCC to establish "reasonable limits" on horizontal and vertical cable ownership. Specifically, Congress in the 1992 Cable Act, directed the FCC to establish limits on the number of subscribers a cable operator is authorized to reach.

Today's Order provides appropriate justification for a 30% limit on horizontal ownership. We therefore respond to the D.C. Circuit and Congress's mandate. In so doing, we ensure that a single operator cannot unduly limit the viability of a new independent network in its formative years. As Congress observed, it is important that we "ensure that no cable operator or group of cable operators can unfairly impede, either because of the size of any individual cable operator or because of joint actions by a group of operators of sufficient size, the flow of video programming from the video programmer to the consumer." 47 U.S.C. § 533 (f)(2)(A).

As with all our ownership rules, it is important that the Commission promote competition and the diversity of voices.

STATEMENT OF
COMMISSIONER MICHAEL J. COPPS

Re: *The Commission's Cable Horizontal and Vertical Ownership Limits*; *Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992*; *Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996*; *Review of the Commission's Regulations Governing Attribution of Broadcast and Cable/MDS Interests*; *Review of the Commission's Regulations and Policies Affecting Investment in the Broadcast Industry*; *Reexamination of the Commission's Cross-Interest Policy*.

I'm pleased that we have finally complied with our statutory obligation and the 2001 court remand and re-established our horizontal cable ownership limit. The 30% limit should help ensure that no cable operator, because of its size, is able to unfairly impede the flow of video programming to consumers. Although the percentage cap remains the same, the underlying economic justification is quite different and is, I believe, completely responsive to the issues raised by the D.C. Circuit Court. I recognize that setting a prophylactic limit like this is never easy, and inevitably involves some line-drawing that can always be second-guessed. But just because the task Congress gave us is difficult is no reason to shirk it.

It is with some disappointment, however, that I note we are initiating yet another *Further Notice of Proposed Rulemaking* on our vertical ownership rules. These are the rules that provide a structural limit on the amount of capacity a cable operator can devote to affiliated programming. In other words, vertical ownership rules would ensure that cable operators open at least part of their systems to independent programming. Unfortunately, this NPRM marks the ***third*** time since the 2001 Court remand that we have put this issue out for comment without moving forward to a decision. It's reminds me of the movie *Groundhog Day*. I keep re-living the same scene over and over again. But maybe this time we will get it right and finally adopt a rule that provides the breathing room for independent programming that Congress intended. That would be a significant win-win, giving consumers access to some honest-to-goodness diversity in their programming and providing the creative community with the access to distribution it needs to survive and to thrive.

STATEMENT OF
COMMISSIONER JONATHAN S. ADELSTEIN

Re: *The Commission's Cable Horizontal and Vertical Ownership Limits*; *Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992*; *Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996*; *Review of the Commission's Regulations Governing Attribution of Broadcast and Cable/MDS Interests*; *Review of the Commission's Regulations and Policies Affecting Investment in the Broadcast Industry*; *Reexamination of the Commission's Cross-Interest Policy*.

Our media frames our society both as an outlet for individual expression and as a reflection of our collective values, diversity, and creative voices. With so much riding on the vitality, openness, and diversity of our media, this Commission has an obligation to engage in a careful, comprehensive and thoughtful review of our ownership rules for cable systems, which serve as the primary video delivery platform for so many American consumers.

I have long expressed concerns about the negative effects of media consolidation for this country, and I have encouraged the Commission to adopt well-justified rules addressing both horizontal ownership limits for cable operators and the problems raised by growing vertical integration of programming and distribution. Although we push off decisions on many important questions of vertical ownership into the attached Further Notice, I am pleased that we finally establish in this Order sustainable horizontal cable ownership rules, as directed by Congress almost 15 years ago in Section 613(f) of the Act.

Section 613 directs the Commission to enhance "effective competition" and makes clear that Congress was concerned that unchecked growth of cable providers could increase their incentives to foreclose or engage in other anticompetitive practices against independent, unaffiliated programmers. As the U.S. Court of Appeals for the District of Columbia (D.C. Circuit) observed, the Commission has identified important governmental objectives in setting horizontal ownership limits, including ensuring that cable operators do not preclude new programming services from reaching a critical mass of viewers necessary to survive, and preserving a diversity of information available to the public.[1] So, I support the Commission's decision to adopt a horizontal ownership cap that responds to the concerns of the D.C. Circuit.[2]

As the court noted, the market for the delivery of video programming has experienced significant changes since Congress first directed the Commission to establish a cap. It is important for the Commission to assess the impact of these developments, including the continued growth of direct broadcast satellite (DBS) and the entry of incumbent local phone providers into the video marketplace. For example, in 2001, DBS providers DirectTV and EchoStar served 16 million subscribers, while today they serve approximately 28 million subscribers, representing a growing percentage of the total multichannel video programming distribution (MVPD) market. I take seriously Section 613's admonition that we take into account the dynamic nature of the marketplace. This growth gives increasing merit to the argument that the horizontal ownership rules should be applied to DBS providers, as well. While Section 613 does not explicitly authorize such a cap on DBS providers, the Commission should further explore these issues in the context of its annual video competition reports and consider any appropriate recommendations to Congress.

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[1] *Time Warner Entertainment Co. v. U.S.,* 211 F.3d 1313 (D.C. Cir. 2000) (*Time Warner I*).

[2] *Time Warner Entertainment Co. v. U.S.,* 240 F.3d 1126 (D.C. Cir. 2001) (*Time Warner II*).

As I have often stated, the prospect of new distribution networks holds the promise of reducing the ability of vertically integrated conglomerates from imposing an economic, cultural or political agenda on a public with few alternative choices. While the presence of DBS has reduced cable's dominance, concentration remains a concern. In 2006, the top four MVPDs served 63 percent of all MVPD subscribers. The effects of this continued concentration are reflected not only in the upstream market, but also, in the downstream MVPD market. As the Commission recently acknowledged in its most recent video competition report, DBS competition has not checked cable prices to the same extent as competition from wireline providers.

In this Order, the Commission's focus is trained particularly on the potential influence of cable operators on the upstream programming market. The Order finds that a large cable operator would have the power to significantly undermine the viability of a reasonably popular programming network by refusing to carry it, despite the competitive pressures of DBS and other providers. It is apparent that video programming delivery involves an intricate web of relationships, and this Order attempts to boil these down into an appropriate horizontal limit. Given the contentious nature of this proceeding and its history in the courts, we put our best foot forward in defense of this difficult task. Significantly, this Order embraces the consistent message I have heard from many small and independent creators of local and diverse programming, namely that they find it difficult or impossible to gain access to and carriage on cable systems. This Order is a necessary measure to prevent that problem Congress sought to address from growing more acute.

STATEMENT OF
COMMISSIONER DEBORAH TAYLOR TATE

Re: The Commission's Cable Horizontal and Vertical Ownership Limits; *Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992*; *Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996*; *Review of the Commission's Regulations Governing Attribution of Broadcast and Cable/MDS Interests*; *Review of the Commission's Regulations and Policies Affecting Investment in the Broadcast Industry*; *Reexamination of the Commission's Cross-Interest Policy*.

Section 613(f) of the 1992 Cable Act requires the Commission to establish "reasonable limits" regarding the number of cable subscribers a cable operator is authorized to reach. In 1993, the Commission set the limit at 30%. The Commission's decision was appealed, and was reversed by the D.C. Circuit Court in 2001. In its holding, the Circuit Court found that "While a 60% limit might be appropriate as necessary to ensure that programmers had an adequate 'open field' even in the face of rejection by the largest company, the present record supports no more." Today we are again considering an Order that would set the limit at 30%.

In accordance with the D.C. Circuit Court's directive, we must examine the marketplace, and set a limit that protects competition while promoting successful business models. As the Court said, "Congress also sought to 'ensure that cable operators continue to expand, where economically justified, their capacity,' and it specifically directed the FCC, in setting the ownership limit, to take into account the 'efficiencies and other benefits that might be gained through increased ownership or control.'" In addition to increased efficiencies, we must also remember that cable operators play a crucial role in the deployment of broadband, which continues to be one of the FCC's top priorities.

In 2001, when the Court reversed the 30% cap, the landscape was much different than it is today. DirecTV and EchoStar served 16 million subscribers, or 18% of the MVPD marketplace. Today they serve almost twice that many subscribers, with 30% of the MVPD marketplace. In addition, they have exclusive rights to highly sought after programming that cannot be provided by cable operators.

In 2001, telecommunications giants like Verizon and AT&T had not yet entered the video marketplace. Today these companies are aggressively promoting their video services, and they have an enormous pre-existing customer base on which to draw. The FCC is doing all it can to facilitate entry of competitors into the video market so that consumers will have greater choice. In fact, the Commission's recent franchising decision allows entry into new markets more efficiently than in the past.

Another change in the marketplace is the explosion of online video, which offers programmers yet another means of distribution. Approximately 70% of American households subscribe to an Internet service, and in 2006, three out of five watched video online. We have recently seen ABC, CBS, NBC, and Fox offering episodes of their popular primetime shows on the Internet free of charge. Consumers are also getting video on their mobile phones. Nearly eight million were using their phones to watch video as of October 2006, and the numbers continue to grow. As viewers begin watching programming on these devices-- at any time they choose, from anywhere in the world -- more programmers will likely turn to online distribution.

Programmers today have a greater variety of options than ever before, and are constantly trying new business models, new platforms, new ways of producing and presenting their content. Cable operators are no longer the gatekeepers they may once have been. And where programmers feel they are being unfairly denied carriage, the FCC has a complaint process in place to deal with such disputes. Therefore, it is difficult to see why, in this increasingly diverse video marketplace, the FCC would once again seek to institute a 30% limit on the size of their customer base.

While I recognize our statutory directive to set a limit on the number of subscribers a cable operator can have, I am also mindful of the importance of getting that number right. If the record in 2001 supported no less than a 60% cap, I cannot be persuaded that the record before us today does either. For these reasons, I respectfully dissent.

DISSENTING STATEMENT OF COMMISSIONER ROBERT M. MCDOWELL

Re: *The Commission's Cable Horizontal and Vertical Ownership Limits*; *Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992*; *Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996*; *Review of the Commission's Regulations Governing Attribution of Broadcast and Cable/MDS Interests*; *Review of the Commission's Regulations and Policies Affecting Investment in the Broadcast Industry*; *Reexamination of the Commission's Cross-Interest Policy*.

What we have before today us may be the "Ghost of Christmas Past." Almost seven years ago, the court rejected the FCC's attempt to impose a 30 percent cable ownership cap. So what is the majority doing today? It's sending back up to the very same court the very same 30 percent cap. Maybe this is really the "Ghost of Christmas Present" then. In Charles Dickens' tale, "A Christmas Carol," that ghost carried the specters of "Ignorance" and "Want." Today's order does the same. This order goes out of its way to remain ignorant of current market conditions which obviate a need for a cap. And the order is wanting for any sustainable legal or evidentiary justification to trample on the First Amendment, in defiance of the court's 2001 warning. Certainly, the ghost of the future will foretell an inescapable fate for this order. Its dark, cold epitaph is all but carved on its tomb. This order *will be overturned* by the D.C. Circuit. Even Ebeneezer Scrooge would pry a few coins from his miserly hands to place that bet.

My dissent is focused on three primary concerns:

1) The cap is out-of-date, is bad public policy and is not needed in today's market;
2) The court is sure to strike down the cap again; and
3) The cap is contrary to the existing policy goals of *this* Commission by creating regulatory *dis*parity and asymmetry.

I. The Cap Is Out-of-Date.

In 1992, Congress authorized the Commission, through Section 613, to "prescribe rules and regulations establishing reasonable limits on the number of cable subscribers a person is authorized to reach" in order to prevent any "cable operator or group of cable operators" from "unfairly imped[ing]… the flow of video programming from the video programmer to the consumer."[1] In instructing the Commission to craft these rules, however, Congress was clear that the Commission must "make sure such rules and regulations reflect the dynamic nature of the communications marketplace" and must not "impose limitations which would impair the development of diverse and high quality video programming."[2] Congress also required the Commission to "take particular account of the market structure" of the cable industry and "account for any efficiencies and other benefits that might be gained through increased ownership."[3]

When Congress enacted this section, vertical integration between cable operators and programmers was at about 57 percent, which sparked legitimate concerns regarding potential exclusion of independent programmers by cable companies. In contrast, vertical integration today stands at less than 15 percent. The unwritten story here is that, back then, fewer than 100 national programming

[1] 47 U.S.C. § 533(f)(1)(A), (f)(2)(A).

[2] *Id.* at § 533(f)(2)(E), (f)(2)(G).

[3] *Id. at* § 533(f)(2)(C)-(D).

networks existed; now there are about 550. That's more diversity, not less.

In 1992, the average consumer had a "choice" of only one subscription video provider. Today, the average consumer has a choice of at least three such providers, and sometimes five. In 2001, when the court last looked at the cap, DirecTV and Echostar had a combined 16 million subscribers with an 18 percent market share. Today, they serve over 30 million consumers and have grown to a 30 percent market share. These two companies are now the second and third largest subscription video service providers. DirecTV is now 54 percent bigger, and Echostar is 92 percent bigger. In the meantime, cable's video subscribership is 4 percent *smaller*.

And there are other differences. In 1992 and 2001, phone companies were not in the video business. Now they are - big time. For instance, Verizon alone has almost 1 million video subscribers. Cable overbuilders are much more viable as well. In 1992, there was no public Internet, let alone Internet video. Today there is so much Internet video, that YouTube alone requires more bandwidth than the *entire Internet* did in 2000. And that's not counting new ventures such as Joost, Cinema Now, Movielink and others that allow consumers to avoid traditional subscription video paradigms altogether. In fact, as the FCC's own research shows, by July 2006, 107 million Americans viewed video online and about 60 percent of U.S. Internet users download videos.[4] Furthermore, today's video market will only become more competitive as broadcasters beam new HDTV and multi-cast video programming, over-the-air, for *free*, and as wireless providers build out powerful new platforms using our recently-auctioned Advanced Wireless Services spectrum and the 700 MHz spectrum being auctioned next month.

This order is unnecessary because the bottleneck threat to programming distribution that existed in 1992 no longer exists. Deregulatory policies have spurred new investment and competition in the marketplace. As a result, new delivery platforms and new content providers have sprouted up, supplanting the need for regulation. However, should a programmer find that a cable operator is unfairly excluding its content from carriage, and all other private sector avenues for resolution have failed, then the statute and our regulations allow that programmer to pursue a complaint here at the Commission. But, to date, only two such complaints have been filed—which underscores the point that the majority is concocting an unconstitutional cure for an illness that does not exist. If a viewer wants specific programming not carried by a cable operator, the viewer and the programmer both have a panoply of ways to find each other – certainly more than they had in 1992 or 2001. In short, other less heavy-handed alternatives exist to address the majority's concerns without having to resort to such archaic industrial policy.

II. The Cap Is Sure to Be Struck Down Again by the Court.

Today's 30 percent cap has a smaller chance of surviving appeal than did the ill-fated and ill-advised 2001 30 percent cap. In 2001 in *Time Warner Entertainment Co. v. FCC*, the D.C. Circuit rejected the 30 percent cable ownership cap and imposed a heavy burden on the Commission to adopt any new cap on remand.[5] The court found that the Commission lacked an evidentiary basis for a 30 percent cap and, as a result, did not meet its obligation under the First Amendment to show a "real risk" of "non-conjectural harm" to programmers. The court also rejected the Commission's argument that a 30 percent cap was justified in order to "enhance diversity."

Indeed, the court stated that based on the marketplace evidence in 2001, the Commission could

[4] News Release, FCC, *FCC Adopts 13th Annual Report to Congress on Video Competition and Notice of Inquiry for the 14th Annual Report* 4 (Nov. 27, 2007).

[5] *Time Warner Entertainment Co. v. FCC*, 240 F.3d 1126, 1134 (D.C.Cir. 2001).

justify *at most*, a 60 percent cap—*twice* the number the majority adopts today.[6] Specifically, the court maintained that a 60 percent limit "might be appropriate as necessary to ensure that programmers had an adequate 'open field' even in the face of rejection by the largest company" and that the "present record supports no more." In particular, the court found that the Commission had not given sufficient weight to marketplace developments, especially the increasing success of Direct Broadcast Satellite ("DBS"). The court pointed out that because "DBS could be considered to 'pass every home in the country'" its competitive effect is especially significant. The Court admonished the Commission to account for this fact when considering any new ownership cap. The majority's order does not clear this hurdle, not by a mile. How can the same 30 percent limit that *insufficiently* accounted for DBS in 2001 possibly satisfy the requirements of *Time Warner II* today when DBS is roughly *twice as large* a competitive presence as it was in 2001, and when other competitors are competing vigorously with cable operators? The answer is that it cannot.

III. The Cap Creates Regulatory *Dis*parity and Asymmetry.

Placing a horizontal ownership cap on cable creates regulatory disparity and asymmetry, all at a time when this Commission has been trying to level the regulatory playing field by creating parity. Order after order over the past few years has sought to change the stove-pipe paradigm of old in an attempt to treat similar technologies and services alike, not differently. Today's cap applies only to cable, not to satellite. Furthermore, we don't cap the number of:

- wireline telephone subscribers one company can have;
- wireless subscribers one company can have; or
- websites a company can own.

Even in the era of rapid technological convergence, such asymmetry will only create market distortions that will inhibit investment and innovation. How does that serve the public interest? In a world where cable companies compete directly against telephone companies and others to provide video, voice and data services, restricting the ability of one group of competitors to achieve the economies of scale enjoyed by others undermines years of efforts to spur intermodal competition and violates the well-established principle of competitive neutrality. If the majority sees so many flaws in the cable industry, it should remedy those shortcomings by encouraging competition, as we did with our video franchising order, not through unnecessary and unconstitutional regulation. Likewise, it is ironic that those who are voting today to *limit* cable company growth have consistently voted to *expand* telephone company growth. Such a reversal of policy just for this one sector defies logic.

IV. Conclusion.

Today's item also contains a further notice of proposed rulemaking, seeking comments regarding the cable attribution rules and the vertical ownership limit. While I am not opposed to asking questions about the attribution issues, the answers will make little sense with the 30 percent horizontal ownership cap in place. I hope that our consideration of the vertical limit will be far better-reasoned than today's action.

For these reasons, I respectfully dissent from today's order.

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[6] *Id.* at 1136.