Abusing Consumers and Impeding Competition: The State of the Cable Television Industry, 2002

July 24, 2002

By

Chris Murray
Gene Kimmelman
Dr. Mark Cooper

In return for relaxed industry regulation, the cable television industry and the entire telecommunications sector committed to promoting competition across all industry sectors—yet they have failed to deliver on their promises to Congress, regulators and the American people. Despite the growth of satellite TV, the promise of meaningful competition to cable TV monopolies remains unfulfilled. Cable rates are up 45% since Congress passed the 1996 Telecommunications Act,[1] nearly three times as fast as inflation.[2] The promise of cable competing with local telephone monopolies remains a pipe dream for all but a handful of consumers. And the promise of opening cable systems to the full diversity of Internet Service Providers (ISPs)—which made the dial-up Internet (narrowband) such a positive example of consumer choice—seems to be nothing but hollow words in a cable-dominated, one-ISP-per-cable system world.

In April 1997, Consumers Union[3] first presented the Senate Commerce Committee with testimony documenting numerous industry exaggerations and unfulfillable promises that fueled your decision to relax regulation of telecommunications and cable.[4] Since then, at least one thing has changed: Wall Street and the entire community of investors woke up to the harsh realities of these markets. No one knows where today's trail of telecommunications bankruptcies, accounting scandals and falling stock prices will lead. According to the Wall Street Journal, "In the last two years, investors have suffered more than $2 trillion in paper loses from a greater than 60% drop in the telecom sector's market value."[5]

Apparently many industry leaders were willing to mislead Congress about how "competitively" they would behave in return for deregulation. They led Wall Street on a wild goose chase in expanding telecom markets that were speculative at best, and then some cooked the corporate books to conceal how irresponsible their behavior had been.

---

[1] Public Law 104-104.

[2] Bureau of Labor Statistics, Consumer Price Index (July 2002). From 1996 until June 2002, CPI increased 16.5% while cable prices rose 44.7%, 2.7 times faster than inflation.

[3] Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education and counsel about goods, services, health, and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of *Consumer Reports*, its other publications and from noncommercial contributions, grants and fees. In addition to reports on Consumers Union's own product testing, *Consumer Reports* (with approximately 4.5 million paid circulation) regularly carries articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

[4] Statement of Gene Kimmelman before the U.S. Senate Committee on Commerce, Science, and Transportation, April 10, 1997.

[5] Yochi Dreazen, *Wall Street Journal*. July 15, 2002, p. A4.

This Is a Free Market?

The Telecommunications Act So Far: Higher Prices, Few Benefits

The Washington Post, January 19, 1997.

Proponents of deregulation sometimes overpromise. In 1995, the Senate Commerce Committee listened to the president of the National Cable Television Association tell the American people that when unleashed from rate regulation, "cable companies are the most likely competitors to local phone monopolies."[6]

> If you look at the entire structure, the competitive theory of the broad legislation in front of this committee, the theory is that you are going to allow the Regional Bell companies to move into manufacturing, information services, burglar alarm services, cable, other areas, and that their potential for anticompetitive behavior is going to be checked because they are going to have competition. And then you look around, and who is going to provide that competition?

[6] Statement of Decker Anstrom, National Cable Television Association Before the U.S. Senate Committee on Commerce, Science, and Transportation, March 21, 1995, S. Hrg. 104-216 at 5, 8, and 25.

> And I would submit to this committee it is us. We are the other wire, and if we do not have the financial and investment environment to make those investments, those tens of billions of dollars, then the end result is that this committee and this Congress will have opened up a Pandora's box in terms of extending the regional phone companies' monopolies, and you will never close it again.[7]

Before Congress clamped down on an unregulated cable industry in 1992, this Committee held hearings to examine the state of the market and inquire into why rates were shooting up and why customer service was atrocious. At the time, one cable company—John Malone's TCI—owned cable systems serving just over 20% of cable subscribers. Key cable program providers such as Viacom warned that this was a dangerous and inappropriate level of industry concentration.[8]

But in the wake of the 1996 Act's deregulation mantra, a wave of mergers engulfed the cable industry. AT&T bought TCI and the former telephone powerhouse became the largest cable company. Then AT&T bought MediaOne. And finally, AT&T now proposes to buy Comcast, giving it a subscriber base of over 32 million subscribers, more than 40% of the cable households in the country. AT&T also has an unusual ownership interest in a division of AOL Time Warner, giving it an ownership stake in systems serving an additional 13 million cable households.

How did this massive acquisition binge occur? Congress and the FCC were given the same promises every time a merger was announced. When AT&T wanted to merge with MediaOne, it explained that ***if only regulators would let them merge***, the combined company—instead of having a mere 10% of its subscribers using cable telephony by the 4th quarter of this year—would have fully 30% of its subscribers buying telephone from the merged company four months from today.[9] Currently, AT&T has approximately 1 million cable telephony subscribers, 90% shy of its promise.

---

[7] Id.

[8] Testimony of Sumner Redstone before the Senate Commerce, Science and Transportation Committee (March 1992).

[9] "As AT&T has previously explained to the Commission, the merger will significantly increase MediaOne's ability to successfully market cable telephony because MediaOne will gain the AT&T brand, customer support systems, marketing experience, and other benefits previously identified to the Commission. In order to estimate the increased telephony penetration MediaOne should achieve, AT&T applied the penetration rate AT&T has experienced in marketing cable telephony in its own cable telephony market ready areas to MediaOne's telephony market ready homes for each of the relevant periods. As explained in the February 22, 2000 submission, where AT&T has rolled out cable telephony it has achieved a telephony penetration rate against telephony ready homes in excess of 1% per month. AT&T therefore applied the conservative AT&T penetration rate of 1 % per month to the MediaOne base of telephony market ready homes to estimate the increased penetration in MediaOne serving areas that would result from the merger. The result of this exercise is shown on the attached chart. The entry labeled "M-1/AT&T Pen" substitutes the AT&T cable telephony penetration rate for MediaOne's penetration rate standing alone in order to reflect the benefits MediaOne will obtain through the merger. This shows that MediaOne's penetration rate (with the benefits obtained through the merger) would increase from roughly 10% to 30% by the 4th quarter 2002." *AT&T Letter to Royce Dickens, Cable Services Bureau, March 29, 2000.* In the Matter of Applications for Transfer of Control to AT&T Corp. ("AT&T") of Licenses and Authorizations Held by MediaOne Group, Inc. CSB Docket No. 99-251.

The attached article from this month's Consumer Reports describes how deregulation of cable and other industries has been no panacea for consumers (See Attachment A). When this type of distortion conceals inadequate competitive forces in markets and leads to lax regulatory oversight, it does much more than leave consumers shortchanged; it undermines the fundamental checks and balances that are essential to our market economy. **Consumers Union believes it is time for Congress to step in and make sure that the laws and regulations governing both cable television and the telecommunications industry provide the types of checks and balances that current market conditions require to ensure reasonable process, high quality service and maximum choice.**

Until recently, public policy for telecommunications involved handing out public benefits or assets, such as the airwaves or local monopoly franchises, in return for obligations to meet public needs – broadcasting to meet local civic and educational needs, and ensuring universally affordable telephone service. This straightforward quid for quo left companies that were dependent on public assets obligated to meet public needs that market forces failed to satisfy. Now, in the era of deregulation, public benefits or assets have increasingly been handed out in return for nothing more than corporate promises – promises to deliver High Definition Television, cross-industry competition, and expanded availability of open platforms providing broadband services. Unfortunately, this new approach to policy means inadequate industry accountability and opens the door to competitive and consumer/investor abuse. It is time to restore accountability through reinforcing the appropriate mechanisms to deliver public benefits in return for public assets or subsidies.

Consumers Union simply asks for one thing: for Congress and regulators to align public policy with real market conditions. Public policy should match up with today's market reality, not with what industry tells Congress market conditions will be next year, not what corporate executives promise the market will look like if only policymakers deregulate a little more. Time has shown that the promises of the cable industry and most telecommunications firms were worth about as much as the air used to utter them.

The Cable Industry's Abuse of Market Power

In this paper, we focus first on the fruits of undue cable industry market power: consumers' skyrocketing cable rates. We then turn to where and why competition has failed to develop. This involves examining the structure of cable's market power which gives the largest multiple system operators (MSOs) multiple levers over video programming, the ability to operate closed broadband Internet systems, and the reach to carry out the discriminatory pricing practices that shuts out competitors.

In the late 1990s, the head of the Justice Department's Antitrust Division called the cable industry "one of the most persistent monopolies in the American economy."[10] Things have only gotten worse since then. The cable industry continues to abuse market power

[10] Statement of Joel Klein, Asst. Attorney General (May 12, 1998), announcing Justice Dept. suit to block Primestar Inc. from acquiring Direct Broadcast Satellite assets of Newscorp and MCI.

in video markets and extend it into advanced telecommunications markets. Claims that competition from alternative technologies is sufficient to discipline cable in either the video distribution or high-speed Internet access market are not supported by empirical evidence. The AT&T Comcast merger, currently under review by public officials, would take a highly concentrated industry to unprecedented—previously illegal—levels of concentration. It would make life worse for consumers who are captive to cable monopolies.

Congress's excessive optimism in the 1996 Act about the development of cable competition was totally misplaced. One of the great disappointments of the Act has been the failure of competition from alternative technologies.[11] Congress devoted a whole section of the law to telephone competition for cable through open video systems.[12] Open video systems are non-existent.[13] Cross-technology competition from satellite is weak as well. This track record demonstrates why policymakers should be very skeptical of promises about future technologies that are "just around the corner," which will break the grip of the cable monopoly.

The market power of the cable operators is most apparent to consumers in the pattern of pricing and monopoly profits since passage of the 1996 Act. Since the beginning of 1996, cable prices have increased 45%, more than two-and-one-half times the rate of inflation.[14]

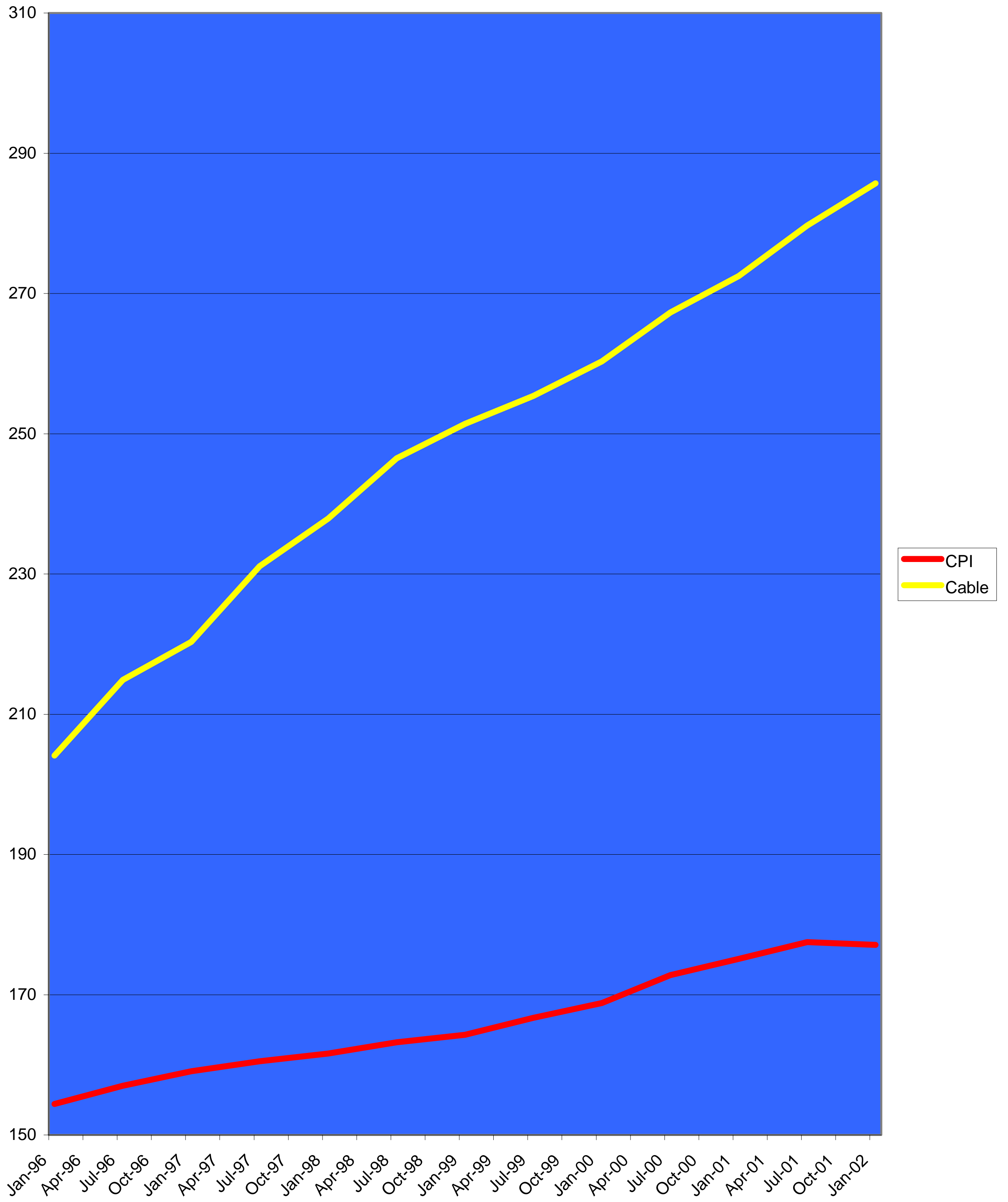
---

[11] Mark Cooper and Gene Kimmelman, The Digital Divide Confronts the Telecommunications Act of 1996, February 1999.

[12] Title II, part 5.

[13] Federal Communications Commission, *In the Matter of Annual Assessment of Competition in Markets for the Delivery of Video Programming*, Fifth Annual Report, Appendix C.

[14] U.S. Bureau of Labor Statistics, *Consumer Price Index.*


Cable v. CPI, 1996-Present
310
290
270
250
230
210
190
170
150
Jan-96
Apr-96
Jul-96
Oct-96
Jan-97
Apr-97
Jul-97
Oct-97
Jan-98
Apr-98
Jul-98
Oct-98
Jan-99
Apr-99
Jul-99
Oct-99
Jan-00
Apr-00
Jul-00
Oct-00
Jan-01
Apr-01
Jul-01
Oct-01
Jan-02
CPI
Cable

In the last year alone, basic cable rates in Atlanta and Austin have gone up 10 percent.[15] In Boston and Chicago cable rates have risen 12 percent.[16] People in Reno, Nevada are paying 15 percent more for cable.[17] And in St. Louis, cable rates are scheduled to increase this fall by as much as 48 percent.[18]

The cable industry claims these rate increases are justified by infrastructure investment and programming cost increases. However, a more detailed analysis of their cost structure reveals that revenue from other sources—such as increases in advertising revenue, digital cable revenues, and new broadband Internet service revenues—more than cover those additional costs. A recent New York Times article noted that cable industry will make 20 percent more in advertising revenue this year than last, and will tie the record it set before the start of the 2000-01 season.[19]

Secondly, the largest cable system operators have financial interests in about one-third of all national and regional programming. So when cable companies complain about having to pay more for programming that they partly own, some are simply taking money of the right pocket and putting it in the left pocket.

Even at the local level, the cable industry's complaint about rising programming costs does not hold water. Since the passage of the 1996 Act, cable revenues have increased much faster than costs. Since 1996, total revenues have increased by 50 percent, while operating revenues are up 43 percent.[20] Average operating revenues (total revenues minus operating costs) have actually increased by 32 percent.[21] Most notably, the revenues that are associated with the expansion of systems—advertising, pay-per-view and shopping services, advanced services and equipment—are up 123 percent.[22] The dollar value of revenue increases for new and expanded services since 1997 alone swamps the increase in programming costs. Virtually all of the increases in basic and expanded basic service revenues have been carried to cable's bottom line in the form of increases in operating profits.

The cable industry's market power to set prices results in the collection of monopoly rents (that is, revenues that exceed competitive levels). One frequent measure of monopoly power is the ability of owners to sell their assets for more than it would cost a competitor to build them, if competitors could enter the market (a measure called Tobin's Q). For instance, if it would cost a competitor $1,500/subscriber to build a new cable system, yet the incumbent cable provider is able to sell its systems for $2,500/subscriber, the $1,000 difference is what Tobin's Q measures—asset sale price above the cost of

---

[15] Austin American Statesman, "Time Warner is upping cable rates," November 28, 2001; Atlanta Journal Constitution, "AT&T Broadband to raise cable fees for Metro Atlantans," November 3, 2001.
[16] Boston Globe, "AT&T Broadband will hike cable rates," November 2001; Chicago Tribune, "Troubled RCN to boost cable rates," May 8, 2002
[17] Associated Press, "Cable television rates to jump in northern Nevada," November 26, 2001.
[18] St. Louis Post-Dispatch , "Charter is boosting cable rates for many," July 18, 2002
[19] Stuart Elliott, "Higher Cable Television Ad Sales." New York Times, July 17, 2002.
[20] *FCC Seventh Video Competition Report* at 1002, Table B-6.
[21] *Id.*
[22] *Id.*

constructing new facilities. The difference in those two prices indicate the presence of market power.

Monopoly rents are paid because barriers to entry allow incumbents to sell assets above their competitive market value. Sales prices for cable systems have increased sharply, whenever prices are deregulated. Since the passage of the 1996 Act, sales prices of systems have more than doubled[23] and monopoly rents collected by cable companies have increased accordingly.[24] The measure of market power tracks real price increases closely—despite enormous growth in the satellite industry.

Public policy has come to rest on satellite as the primary source of meaningful competition for cable. Unfortunately, because of its cost and other characteristics, satellite has fallen far short of providing widespread, vigorous competition. The FCC's own analysis has consistently shown that satellite does not now, nor has it ever, exerted a significant competitive effect on cable industry prices, quantity or quality. Furthermore, satellite services—like many other entrants and would-be competitors to cable—are hampered by cable industry efforts to shut it out of the market for popular programming.

Satellite has obtained the bulk of its subscribers from geographic areas not served by cable and from communities where cable systems did not have a digital offering. In a nationwide survey of satellite and cable customers, fully 40% of satellite subscribers say

---

[23] See Id., for system prices. For an explanation and interpretation of monopoly rents embedded in these prices see "Comments of the Consumer Federation of America, Consumers Union, Center for Digital Democracy, The Office of Communications of the United Church of Christ, Inc., National Association of Telecommunications Officers and Advisors, Association for Independent Video Filmmakers, National Alliance for Media Arts and Culture, and the Alliance for Community Media," in *Federal Communications Commission, In the Matter of 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 The Commission's Cable Horizontal and Vertical Ownership Limits and Attribution Rules 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*, CS Docket No. 98-82, CS Docket No. 96-85, MM Docket No. 92-264, MM Docket No. 94-150, MM Docket No. 92-51, MM Docket No. 87-154, January 4, 2002; and Reply Comments of the Consumer Federation of America, Consumers Union, Center for Digital Democracy, and Media Access Project, in Federal Communications Commission, *In the Matter of 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 The Commission's Cable Horizontal and Vertical Ownership Limits and Attribution Rules 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,* CS Docket No. 98-82, CS Docket No. 96-85, MM Docket No. 92-264, MM Docket No. 94-150, MM Docket No. 92-51, MM Docket No. 87-154, February 19, 2002,

[24] Market power is also frequently measured by the Lerner Index, which is the mark-up of price above costs (see F. M. Scherer, F. M. and David Ross, Industrial *Market Structure and Economic Performance* (Boston, Houghton Mifflin: 1990), pp-21-22 ; Landes, W. M. and R. A. Posner, "Market Power in Anti-trust Cases," *Harvard Law Review*, 19: 1981, p. 947. Tobin's q is a direct measure of monopoly rents (which is the ratio of asset value to reproductions costs (Scherer and Ross, at 415... 416). Therefore, we would expect price and Tobin's q to parallel one another, holding costs constant. The increase in HHI can be directly related the Lerner Index by dividing by the elasticity of demand ((W. Kip Viscusi, John M. Vernon, Joseph E. Harrington, Jr., *Economics of Regulation and Antitrust* (Cambridge, MIT Press: 2000), p. 149). Most recently the elasticity of demand has been estimated by the FCC at 2.19 ("Report on Cable Industry Prices," *In the Matter of 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*, February 14, 2002 (hereafter, Price Report 2002), p. 29), which would suggests increasing monopoly rents consistent with the price and Tobin's q numbers.

that they cannot get cable.[25] In this sense, satellite does not compete in the market with cable; it serves markets that were adjacent to the cable market. Until recently, satellite also drew substantial subscribers from consumers who want higher quality (i.e. digital), much more specialized programming (e.g. large sports packages, more movie channels) than cable has offered. However, in the past several years, since cable has been rolling out its digital offering, cable has been adding digital subscribers at a much higher rate than satellite and is now bundling high-speed Internet with digital service. This is a bundle that satellite cannot match.

In other words, having never been threatened by satellite for its core "lunch bucket" market, cable is now attacking satellite's niche with its digital service. Our analysis elsewhere[26] demonstrates that the weak and narrow competitive overlap between satellite and cable is likely to become weaker and narrower in the foreseeable future.

Moreover, allegations have surfaced that cable is using its market power to forestall competition by attempting to deny satellite critical programming through exclusive arrangements.

For instance, a lawsuit currently pending between Yankees Entertainment & Sports Network and Cablevision alleges that cable customers simply have no competitive alternative to cable, and cable intends to keep it that way. [27]

> The overwhelming majority of Cablevision's subscribers have no fully competitive alternative to Cablevision given the low DBS penetration in the greater New York metropolitan area, the limited success of overbuilders within its franchise areas, the cost and limitations of switching from one subscription television service provider to another, and technical limitations on DBS reception. DBS reception requires an unobstructed view of the southern sky, and often is unavailable because of buildings, trees, and other obstructions, as well as prohibitions by many building owners and cooperative boards. Moreover, Cablevision has taken active steps to dissuade consumers from switching where alternatives are available, offering discounts, free service, and special combination packages to alter the appearance of the value of the service provided by Cablevision.[28]

Lack of access to critical programming—especially regional sports programming—makes it difficult for new entrants to compete with incumbents. As the FCC's 8th Annual Video Competition Report notes:

> The more that the programming package offered by a competitive multichannel video programming distributor (MVPD) lacks the "must have" programming that is a part of

---

[25] Consumer Federation et al., testimony submitted to the Subcommittee on Antitrust, Business Rights and Competition, Senate Judiciary Committee, on the AT&T/Comcast Merger. April 23, 2002.
[26] Id.
[27] Yankees Entertainment & Sports Network, LLC v. Cablevision Systems Corp. and CSC Holdings, Inc.. (U.S. Dist., SDNY), Complaint submitted Apr. 29, 2002, at 22.
[28] Id. at 21.

> the incumbent cable operator's programming package *(i.e.*, the new entrant offers a similar, but differentiated product) the less attractive the competitive MVPD's programming package will be to subscribers. Thus, we find that an MVPD's ability to provide a service that is competitive with the incumbent cable operator is significantly harmed if the MVPD is denied access to popular, vertically integrated programming for which no good substitute exists. We further find that, given the unique nature of cable programming, there frequently are not good substitutes available for vertically integrated programming services, including services that are considered "must have" programming by competitive MVPDs and the subscribers they serve, such as regional news and sports programming. Accordingly, we conclude that vertically integrated programmers continue to have the ability to favor their affiliated cable operators over competitive MVPDs in a manner that would competitively harm such MVPDs in the absence of the prohibition.[29]

In Philadelphia, Comcast has used a loophole[30] in the Telecom Act, to avoid sharing Philadelphia sports teams' programming with satellite, resulting in satellite penetration about half of what DBS operators achieve in other large cities.

> DIRECTV and EchoStar assert that their significantly lower subscribership in Philadelphia as compared to other large cities is directly attributable to their inability to access Comcast SportsNet. *Economic Assessment* at 24. DBS subscribership in Philadelphia is 3.9 percent, or less than half the 9.3 percent weighted average of the top 20 largest cities (excluding Philadelphia). *Id.* at 22-24. We note that, in other contexts, parties have challenged EchoStar's DBS penetration figures for the Philadelphia market (asserting that it ranges from 5.3 percent to 8.5 percent) using different reference sources than the *Economic Assessmen*t. *See Applications for Consent to the Transfer of Control of License*s, MB Docket No. 02-70 (AT&T Corp/Comcast Corporation Reply to Comments and Petitions to Deny Applications for Consent to Transfer Control at 104). Using either figure, it is apparent that DBS penetration in Philadelphia is well below the 18 percent national penetration rate.[31]

The combination of cable companies tendency to favor their own programming, in conjunction with special bargaining power granted to broadcasters by Congress (i.e. guaranteed signal carriage on cable systems or preferential treatment in bargaining for signal carriage), leaves virtually no avenue for independently-owned programming to break into the video market today.

A survey of the top 20 cable services ranked by subscribership[32] reveals that 19 of the top 20 networks are owned by either large cable companies or a national broadcaster. Out of the top 20 programming services by prime time rating, 18 are owned by a national

---

[29] *FCC Report and Order, In the Matter of Implementation of the Cable Television Consumer Protection and Competition Act of 1992; Development of Competition and Diversity in Video Programming Distrubtion: Section 628(c)(5) of the Communications Act, Sunset of Exclusive Contract Prohibition. CS Docket No. 01-290.*

[30] Cable companies are required to give competitors (such as DBS) access to programming if they distribute it on a satellite uplink. Public Law 104-104, Section 528. However, many MSOs skirt this requirement by distributing their signal to cable headends via terrestrial wires.

[31] Id. at FN 107.

[32] FCC 8th Annual Video Competition Report, Table D-6.

broadcaster or large cable company.[33] Virtually no independent content—save the Weather Channel and the Home and Garden Network—has a reasonable chance of success on cable systems.

The cable industry would have policymakers believe that when Congress required that a cable horizontal ownership be put in place to ensure the development of independent programming, all it intended to do was protect national broadcasters. But this claim is contrary to the express aims of the 1992 Cable Consumer Protection Act.[34] The broadcast industry's interests were safeguarded by Must Carry/Retransmission Consent, which required cable operator's to carry broadcast signals in local markets where the broadcaster operates, or allowed broadcasters to bargain for payment or extra channels from cable companies, whenever broadcasters have leverage to obtain more than signal carriage (e.g. for "must have" programming such as ESPN). If all Congress intended to do was to protect "independent" broadcast programming, they could have stopped at Must Carry—a cable ownership limit would have been redundant.

But Congress unambiguously sought to protect the interests of true independent creators of content, to provide a bargaining power counterweight for individual producers not affiliated with either a cable system or national broadcaster.

This grim picture of impediments to cable competition does not mean that competition does not work. In fact, wherever an overbuilder builds such a system, cable rates drop dramatically and service improves ("overbuilders" are competitive cable systems that decide to compete directly against an incumbent cable company by duplicating a part of the incumbent's system). A Los Angeles Times article on cable overbuilders examined rates all across LA County for basic and expanded basic cable service, comparing towns where there was competition with towns where there was not.

That article found that basic cable was 60% more expensive in cities without competition (39% on a per channel basis), and expanded basic was 15% more where there was no competition (29% on a per channel basis).[35] FCC data also show that wire-to-wire competition yields at least a 9% cost saving for consumers.[36]

However, there are manifold barriers to entry for would-be cable competitors. Incumbent cable companies often successfully lobby local governments to deny rights of way to new cable companies. Cable companies extract exclusive contracts from multiple dwelling units (large apartment buildings), denying competitors access to some of the most economically attractive subscribers (since high density often means lower construction costs).

But by far the most significant barrier to entry for cable overbuilders is the largest incumbent cable operators' ability to deny programming to competitors, or offer them

---

[33] Id. at Table D-7.
[34] PL 102-385.
[35] Margaret Talev, *"Consumers Have Little Recourse on Cable Rates."* Los Angeles Times, Feb. 4, 2001.
[36] 8th Annual MVPD Competition Report, Jan. 14, 2002. CS Docket 01-129.

such high prices for “must-have” programming that the competitive cable system is unable to make a profit on its service offering.

Unfortunately, the FCC has failed to foster competition when it had the chance. The FCC recently fumbled an opportunity to facilitate video competition by allowing terrestrial reuse of satellite spectrum.[37] By keeping a closer eye on maximizing auction revenues[38] than on ensuring increased competition for video services, it is extremely unlikely that FCC policies will promote competition in the foreseeable future..

The FCC has also continued to accept the hollow promises of industry that have failed to open broadband networks to competitors. When cable operators decided to enter the communications business by offering high-speed Internet access, they incurred the obligations to operate those systems in an open and nondiscriminatory manner. Industry and the FCC jointly arrived at the conclusion that the best policy would be to meet that obligation in a voluntary manner.

But the cable industry has broken this promise—the commitment to Congress, the FCC and the American public—that it would voluntarily provide non-discriminatory access to their broadband service offering. Cable companies broke that promise by dragging their feet for three years, in the meantime capturing the most lucrative broadband customers under exclusive arrangements. The terms and conditions that they now offer for access are completely antithetical to a true open communications system.

With the exception of AOL Time Warner’s open access commitment, enforced by a Federal Trade Commission Consent Decree, the commercial access that cable companies are offering is nowhere near what is needed to preserve the competitive, consumer-friendly, innovation-rich environment we have come to appreciate from the Internet. This new closed model means that the cable owner

- chooses a small number of ISPs who can sell a restrictive set of services;

- tells the ISPs what they can and (more importantly) cannot sell, particularly streaming video and end-user generated content and applications;

- controls the customer relationship and the ability of non-affiliated ISPs to differentiate themselves; and

- places independent ISPs in a price squeeze that stifles innovation on the Internet by charging such a high toll for access (the charge unaffiliated ISPs must pay for

[37] *Federal Communications Commission, Order to Authorize a Multichannel Video Distribution and Data Service, ET Docket 98-206.*

[38] The Component Economic Area (CEA) parcelization of this spectrum was apparently proposed in an ex parte filing by AT&T wireless. Because CEAs will not match Designated Market Areas (DMAs), it may be difficult for would-be MVDDS video providers to sell advertising.

> carriage) so high that few resources are available to develop new applications or content.[39]

Cable operators have a strong incentive to retard innovation that might compete directly with their core video services, or even indirectly for consumer video entertainment attention. Restricting the number of service providers and the services they can provide ensures cable companies control the flow of innovation and takes away the incentive to develop new applications. This is the antithesis of how the Internet was created. In the narrowband Internet, intramodal competition for content – ensuring that content providers and applications developers were given non-discriminatory access to facilities – was highly successful in stimulating entry and innovation.

There are only 47 high-speed Internet service providers using cable modem service nationwide – essentially the monopoly cable companies offering service on an exclusive basis in their franchise areas. This number has been virtually constant for past two years. There are almost three times as many high-speed Internet access service providers using other technologies, and this number has almost doubled in the past two years.[40]

The final way cable has blocked competition—and the FCC has failed to act—has been in cable's failure to develop an open market for set top boxes.

Cable companies promised the Commission and Congress that they would abide by the terms of the 1996 Telecommunications Act and allow the development of a competitive set-top box marketplace to move forward. The industry has broken that promise—cable operators have ensured that they will retain their lucrative customer equipment cash cow by keeping the Cable Labs standards process closed. The best evidence of the cable industry's resistance to a competitive market place is demonstrated by their recent arguments that FCC requirements already adopted should be eliminated. Specifically, NCTA has recently lobbied the FCC to remove the requirement that all set-top boxes contain POD-host devices by 2005. Removal of this requirement would end any hope for consumers of a truly competitive set-top box market.

Some companies also use their analog set-top box leasing schemes to subsidize digital set-top boxes—evidenced by the fact that analog boxes cost the same as digital boxes when customers lease them monthly, but if a customer breaks his or her analog box, that customer must pay $200, whereas if he or she breaks a digital box the customer must pay $800.[41] Adelphia's deceptive accounting practices also present additional evidence of how the MSOs and captive manufacturers have used the cost-pooling and subsidy practice to profit at the expense of the cable consumer.

The cable industry has a powerful interest to ensure that this market remains closed. By slow-rolling the technical standard and forcing would-be set-top box competitors to sign an egregious licensing agreement whereby the company signing the agreement would

---

[39] Consumer Federation et al., testimony submitted to the Subcommittee on Antitrust, Business Rights and Competition, Senate Judiciary Committee, on the AT&T/Comcast Merger (April 23, 2002) at 13.
[40] Id. at 14.
[41] Id. at 19.

have to virtually forfeit their intellectual property, the cable operators have killed any near term possibility of an open set-top market. The longer-term prospects are even more serious. Today, the MSO's captive manufacturers are beginning to build integrated home entertainment and home networking devices that will connect to both the cable system and the Internet. The MSOs intend to use their control of these new generation set top boxes to regulate not only what viewers can receive from their cable system but also their ability to watch streaming video and other Internet-based services provided by competitors.

Policy Recommendations

We conclude where we started by asking for one thing: for Congress and regulators to align public policy with real market conditions, not with illusions about an ideal competitive world that industry leaders always claim will emerge if policymakers only deregulate a little bit more.

First, the Federal Communications Commission should encourage the development of new technologies to compete with cable. The Commission has a statutory duty to minimize mutual exclusivity and it failed to fulfill that duty in its recent Multi-Channel Video and Data Distribution Service (MVDDS) rulemaking.[42] Instead of ensuring that a competitor interested in offering video services develops, the Commission appears more interested in maximizing auction revenues. Congress should direct the FCC to ensure that this secondary spectrum is used for immediate video competition.

Second, given the slow growth of competition, Congress should provide states the same power over cable monopolies that they have over telephone monopolies by shifting cable oversight from the FCC to the states, achieving greater parity between telephone and cable regulation.

Third, the FCC must limit concentration that blocks competition in both the transmission and content markets, by using the detailed empirical evidence in its database to justify the 30% cable horizontal ownership limit. Congress has required the FCC to develop such a limit; although past Commissions did not justify the rule with sufficient rigor, it is incumbent on the current FCC to do so.

Fourth, the FCC should be required to open the cable broadband Internet platform to ensure diversity and competition for content. If this country wishes to continue to lead the world in technology and business innovation, the next-generation Internet should mirror the openness of the current Internet, rather than turning it into a cable-controlled walled garden.

Finally, Congress should prevent discrimination that prevents potential competitors from getting content. A critical step would be to close the "Terrestrial Bypass" loophole of the Act, which allows cable companies to avoid sharing content by distributing it over

---

[42] ET Docket 98-206.

terrestrial wires rather than by satellite, and by expanding other non-discrimination requirements to cover all popular programming.