S. HRG. 108–494

[ERRATA]
CABLE COMPETITION—INCREASING PRICE; INCREASING VALUE?

HEARING

BEFORE THE

SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY AND CONSUMER RIGHTS

OF THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

ONE HUNDRED EIGHTH CONGRESS

SECOND SESSION

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QUESTIONS AND ANSWERS

April 29, 2004

Mike DeWine
Chairman, Subcommittee on
Antitrust, Competition Policy,
and Consumer Rights
161 Dirksen Senate Office Building
Washington, DC 20510

Dear Senator Dewine:

Knology is pleased to provide you with the following responses to the questions presented in your letter to Mr. Rodger Johnson dated March 15, 2004. My name is Felix Boccucci and I am Vice President – Business Development for Knology, Inc. I am respectfully responding on behalf of Mr. Johnson. For your convenience we have provided our responses in a "Q&A" format in the attached document.

Should you have any further questions, please do not hesitate to call me at (706) 645-8567.

Sincerely,

Felix L. Boccucci, Jr.
Vice President – Business Development

cc: Robin Blackwell
Rodger Johnson – Knology, Inc.
John Goodman – BSPA

Enclosure

Response to Senator Specter's questions:

Q 1. **"It is important that we continue to look for ways to ensure the continued vitality of competition in the multi-channel video programming distribution (MVPD) marketplace. It seems the cable industry now faces real competition from the DBS industry which has grown rapidly since its inception in 1994. It is, in part, due to this competition that cable responded by upgrading its systems, investing over $80 billion to upgrade its digital broadband network systems. And the innovation is just beginning – IP phone service, which promises to create real consumer choice by spurring facilities-based competition in the local telephone market, is right around the corner. Cable companies currently serve 2.5 million residential telephone subscribers using cable lines, and are developing a new technology for delivering telephone service, known as "IP Telephony" or VOIP (voice over internet Protocol)"**

A 1. The true level of competition would be better understood if evaluated on a market by market basis. Market based data is not currently available. Senators DeWine and Kohl have sponsored a new GAO Study to evaluate different types of market structures and related competition. In our experience, DBS providers do not provide significant competition against a cable system upgraded to provide digital video and other bundled services. With the significant investments cable operators have made in their networks, we believe that a market by market study will show that DBS provides inadequate competition to upgraded cable services. We expect that such a study will show that incumbent cable has been rebuilding monopoly like or monopsony market shares of 90-95%. If this condition proves to be true, it prompts an important fundamental policy question. Is it appropriate to declare a market fully competitive when one supplier has a sustained market share of over 90%?

Q 2. **"The GAO was asked to examine a sample of markets where cable overbuilders are present and compare competitive conditions with a sample of similar markets in which cable operators do not operate. Senators Kohl and DeWine want to know what effects such cable overbuilders have on cable prices and quality of service. A key question in my mind is whether these overbuilders are offering rates and services that will be able to provide long-term, sustainable competition to both cable incumbents and the nation's two large DBS companies. So how are overbuilders faring in the marketplace today?"**

A 2. Current Broadband Service Providers (BSP's), also referred to as "overbuilders", are demonstrating their market success and financial viability. Mature, more fully built systems are showing sustained customer penetration rates that range from 25% to over 40%. Customers subscribe, on average, to more than 2 services per account. Many of these systems are self sustaining, cash flow positive and

becoming profitable. Improved investment returns and higher profits will primarily be a function of additional scale that can be supported by existing overheads and operating structure. The Kohl and DeWine GAO study was sponsored to uncover the market impact of the more established BSP Systems. The study confirmed a BSP market impact that is far more significant than DBS based competition.

Knology provides a good example of the financial success of a competitive business model. Knology recently completed a successful initial public offering. We believe that this is the first initial public offering in the telecom/media sector in over three years. Knology became the 20th largest cable provider with its recent acquisition of a competitive cable network in Pinellas County, Florida. Other BSPs have continued to spend capital and to expand their networks. We believe that our continued growth and success over the last six years provides a clear and convincing statement as to the health of BSPs.

Response to Senator Kohl's questions:

Q 1(a) "The FCC's Video Competition Report released in January 2004 shows that the cable industry's earnings continue to rise, and at a very healthy rate. The FCC reported that the cable industry operating cash flow increased more than 25% since 2001, and its cash flow to revenue ratio – which many consider to be a rough approximation of profits – was 41% in 2003. Don't these high earnings show that the cable industry does not really have to pass along all the programming price increases to consumers?"

A 1(a) Increasing content costs (programming prices) do cause economic pressure to increase retail prices. However, Knology, as a competitive provider of cable services has a limited ability to increase its retail rates. Without wire-line facilities based competition, cable providers are not similarly limited. The BSPA firmly believes that effective wire-line competition is the best regulator of price increases.

Q 1(b) "Your company, Knology, has to pay the same cable programming cost increases as the cable incumbents. In your view, do these programming cost increases justify the substantial cable rate hikes we have all seen?"

A 1(b) In the majority of all of its operating markets, Knology is the competitor rather than the incumbent cable provider. As highlighted in the recent GAO study on the benefits of wire-based competition, rates were generally lower in markets with a wire-line cable alternative. The study found that, for example, expanded basic cable television rates were 15 to 41 percent lower in markets with a wire-line cable competitor when compared to the other markets studied which did not have a wire-line cable competitor. The competition that Knology faces does not allow it to pass on increased programming costs at a level similar to that of a monopoly provider.

Q 1(c) "What percentage of your costs are due to the costs of acquiring programming?"

A 1(c) As a bundled service provider, many of Knology's costs are common among its voice, video and data offerings. Therefore it is difficult to determine how much of the costs are associated directly with video service which would provide the percentage requested. However, programming has been Knology's largest single operating expense. In recent years, the cable industry has experienced rapid increases in the cost of programming, particularly sports programming. As detailed in the GAO October 2003 report, between 1999 and 2002 the average license fees for a cable network that shows sports-related programming increased by 59 percent.

Q 2(a) "Mr. Johnson, in his written testimony for the hearing, Mr. Sachs says that cable overbuilders do not have "an economically sound or sustainable model." What's your response?"

A 2(a) BSP's such as Knology are proving the economic strength of their business models with market expansion and positive EBITDA growth. We are aware of a number of other BSPs that have proven their ability to grow their EBITDA margins, expand their networks, and increase their customer base. This has been confirmed by financial analysts in the investment community.

Q 2(b) "Please describe your company's financial performance, earnings and cash flow over the last five years."

A 2(b) Knology's financial performance has continued to improve as detailed in its March 15, 2004 earnings release. Total revenue for 2003 of $172.9 million represented an increase of 21.9% over total revenue for 2002 of $141.9 million. EBITDA, as adjusted of $33.0 million for the full year of 2003 grew 57.2% over EBITDA, as adjusted of $21.0 million for the full year of 2002.

Knology has been a public reporting company since 1998. All historical detailed financial data is available on the Securities and Exchange Commissions website at www.sec.gov.

Q 3. "Knology has competed with the cable incumbents in several different areas. What are the main challenges to your company's ability to survive as a viable competitor to the cable incumbents?"

A 3. Knology has achieved both the initial scale and operations for "survival as a viable competitor". However, incumbent cable providers still wield tremendous power. Knology and other BSP's face critical legislative and regulatory issues that can impact their access to capital. Capital markets can be positively influenced if they have additional confidence that BSP's will have assured access to the content they need to effectively compete and that the cable incumbents will be appropriately constrained from illegal anti-competitive strategies to block

successful new market entries. Anti-competitive strategies they employ include misuse of Level Playing Field statutes, delaying tactics in the franchise process, and predatory pricing tactics that are adopted by incumbent cable operators when a BSP system becomes active for service. Incumbents have demonstrated a clear intent to use access to content as a barrier or strategy to sustain a monopoly market share.

Q 4(a) "The cable industry often claims that cable rates are increasing because of increases in the cost of cable programming. Yet a GAO study release in October 2003 found that a substantial portion of the increase in programming rates – as much as half by some estimates – was recouped by the cable companies in the form of increased local advertising revenues."

"What's your response to the finding in the GAO October 2003 Report? Is it true that a substantial portion of increased programming costs is recouped by cable operators by increased revenues from local advertising?"

A 4(a) The GAO October 2003 study includes findings that only the larger monopoly "cable operators gain significant revenues from the sale of advertising." The study further indicates that, due to the significant costs associated with selling local advertising, smaller competitive cable operators generally do not sell as much as the larger cable operators. Our experience is consistent with this finding in the GAO study. Increasing local advertising rates are not an effective method of offsetting increasing costs in programming for competitive cable providers such as Knology.

Q 4(b) "Don't the GAO's findings mean that cable operators need not pass along all of programming cost increases to consumers?"

A 4(b) It is Knology's belief that the answer to the issue set forth in this question is contained in the GAO's study. As detailed in the GAO study, competition is an effective force restraining retail rates for cable services. Expanded basic rates in markets where Knology is a competitive provider are significantly less than adjacent markets served only by a monopoly cable provider.

Q 4(c) "Please describe how your company's earnings from local advertising have changed over the last five years."

A 4(c) Knology's earnings from local advertisings are nominal in nature when compared to overall revenues. Knology's experience is consistent with GAO's findings that advertising revenue is minimal for all but the largest cable providers.

Q 5. "The Cable Act of 1992 requires that programming owned by cable companies be made available to all competitors on the same terms, but it contains an important exception. This requirement only applies to programming delivered by satellite. But programming that is delivered

terrestrially is exempt from this program access law. This is what many people call the "terrestrial loophole."

(a) "Would you support repealing the terrestrial loophole, so that cable companies could not deny to competitors any programming in which they have an attributable ownership interest, whether or not that programming is delivered via satellite? Why or why not? Would making cable content owned by cable companies available to all competitors enhance competition?"

(b) "Mr. Johnson, if your company is not able to get access to essential programming, such as the local news and sports channels carried by your competitors, does this harm your ability to compete? Has this happened to Knology or to other similar cable overbuilders?"

A 5(a&b) Knology and the BSPA have been advocates of fixing the Terrestrial Loophole for several years. Nothing is more critical than assuring fair access to content. Consumers purchasing decisions are affected by access to content. If one content distributor or group of content distributors has significant exclusive or proprietary access to content versus its competition, it will have market power that can either stifle or impair the development of competition. Knology is currently facing this issue in one of its markets today. When Knology attempted to purchase local news in Pinellas County, Florida, the incumbent cable provider denied Knology access to the programming. In most, if not all cases, the terrestrial loophole allows the incumbent provider to deny competitive access to popular channels.

The BSPA filed its first public comments on this topic during the FCC proceedings regarding the potential 2002 sunset of the current protections offered by Section 628. Since that time the BSPA has offered many additional examples of incumbent cable providers denying competitive access to content.

The FCC, in recent proceedings related to the Comcast/AT&T Merger and the NewsCorp/DirectTV Merger, has consistently acknowledged the potential or probable issue of the need to assure the continued availability of content to competing distributors. Specific conditions were ultimately imposed on the NewsCorp Merger. Additional concerns were voiced regarding a then potential Comcast/Disney Merger.

In summary, nothing is more fundamental to the sustained development and future success of distribution competition than the full assurance of fair access to content. The most problematic circumstance occurs when one distributor or group of non-competing distributors control essential content through vertical integration or other means of influencing the availability of content that would otherwise be made available to all distributors.

Q 5. (sic) "Representatives of the cable industry have argued that we need not worry about competition in the cable industry because cable competes everywhere with satellite television. A few questions –"

(a) "In his written testimony at the hearing, Scott Cleland stated that cable and satellite television seldom compete on price. Do you agree?"

(b) "Is satellite television a competitor for urban residents who live in an apartment building and are unable to receive satellite signals? For these consumers, where there is no overbuilder, isn't cable really the monopoly provider of subscription TV?"

(c) "What about those consumers who want high speed internet services? Is satellite an adequate competitor for these customers?"

A 5 (a-c) We agree that Satellite has not provided significant price competition to cable. There is simply no compelling evidence that it does. By comparison there is very consistent evidence that wire-line competition creates potentially significant price competition.

Satellite has several inherent limitations that make it a poor or unavailable choice for many urban residents. We believe that satellite holds very different market shares in different types of markets. The key is whether wire-line cable service exists and how fully upgraded the cable service is.

Internet service is an example where cable service has clear advantages of speed and reliability compared to Satellite alternatives. Cable Modem service is on the verge of supporting good quality full streaming video. Satellite internet service is a major improvement over dial-up but it is not expected to fully compete with Cable that can and will continue to be upgraded for speed, reliability and capacity.

Q 6. "One of the cable industry's responses to the charge that cable rates are too high is to point to all the new channels that are on cable systems today as compared to ten years ago. But consumer advocates argue that because cable channels are bundled together, and consumers have no choice but to buy all the channels in the bundle, consumers end up paying for channels that they do not watch.

Wouldn't it be better if consumers had a <u>choice</u> of whether to purchase cable channels in the bundle, rather being (sic) forced to paying for extra channels which they may never watch?"

A 6. We believe that any movement toward an a la carte price structure should only be considered with digitally delivered content. Cost and technological issues would render any attempt to create an a la carte pricing structure, which includes current analog channels, a step in the wrong direction. Knology currently offers its

consumers "mini digital tiers" such as a sports and a family programming tier which appears to lead in the desired direction of this Subcommittee.

Today content providers can and do require cable providers to bundle less desired programming with more popular channels on a tier available to all subscribers. This is forcing consumers to pay for high cost content or content they don't want. Creating a policy that would give cable providers a la carte access to content would be beneficial to the consumer, as they would likely see more focused content packages such as those Knology currently offers.

Q 7. For several years, we have heard allegations from competitors of predatory conduct engaged in by cable incumbents against their competitors. These allegations include stories of cable incumbents, when faced with a new competitor entering their market, offering subscribers extraordinary discount off their normal price – prices which appear to be below the cost of acquiring the programming. These discounts are not offered in neighboring communities where the incumbent does not face competition, so they appear to be targeted against cable competitors as an attempt to drive them out of the market.

Mr. Johnson, has your company faced such predatory conduct by cable incumbents? Can you give us some examples? Why do think (sic) the Justice Department has not brought an antirust case regarding this conduct?"

A 7. Not only Knology, but the BSP's in general have faced discriminatory and predatory pricing in their markets. The BSPA has provided a significant amount of data regarding anti-competitive actions by incumbent cable providers to the Department of Justice (DOJ). We are hopeful that the DOJ will move forward swiftly to eliminate these actions.

Q 8. "As we all know, there has been a tremendous amount of consolidation among cable, satellite and media companies in recent years. The latest example is Comcast's current efforts to acquire Disney. Last year, News Corporation acquired a controlling interest in DIRECTV. And the year before, Comcast acquired AT&T's cable assets to create the nation's largest cable system. A significant percentage of cable networks are now owned by the large cable companies or the television networks. Indeed, the FCC's recent video competition report found that seven of the top 15 prime time cable networks are owned by cable operators, and the other eight have at least partial ownership by one of the major broadcast networks.

Should we be concerned that all this consolidation makes it difficult for an independent programmer to obtain carriage on cable systems? For example, if Ted Turner was to start CNN today instead of 20 years ago, isn't it true he would find it very difficult to get carried by cable companies?"

A 8. We believe that the current level of consolidation and vertical integration will have potentially negative impact on the development of independent programming. There are really two issues. The vertically integrated operator would have a natural incentive to favor the support of new content from a content provider it has financial interest in. The second issue that could have broader issues related to free speech and independent voice is the whole area of "gate keeper" status. A recent Wall Street Journal Article referred to Comcast becoming a virtual "gate keeper" where an independent content producer will potentially survive or die based on Comcast's decision. The only real natural solution to this level of market power is to have alternate viable distribution resources that could decide to launch new independent content.

Q 9. "Many of us have been very concerned for quite some time about the content of certain programs available to be seen by our children on cable TV. While we understand that legally cable is not held to the same standard as broadcast TV, we are worried that more needs to be done by the cable industry and that some of the cutting edge program on cable isn't good for all ages.

Should there be a family tier of programming on cable? What else can cable do in this area to help parents protect their children?"

A 9. We acknowledge that this is an issue that needs to be addressed. Knology is currently offering various tiers including a family tier in its markets today. We would welcome a review of any programming restrictions or tiering arrangements that limit Knology's ability to meet customer demands.

Questions for Scott Cleland

Questions from Senator Specter

1. It is important that we continue to look for ways to ensure the continued vitality of competition in the multi-channel video programming distribution (MVPD) marketplace. It seems the cable industry now beginning to face real competition from the DBS industry which has grown rapidly since its inception in 1994. It is, in part, due to this competition that cable responded by upgrading its systems, investing over $80 billion to upgrade it digital broadband network systems. And the innovation is just beginning - IP phone service, which promises to create real consumer choice by spurring facilities-based competition in the local telephone market, is right around the corner. Cable companies currently serve 2.5 million residential telephone subscribers using cable lines, and are developing a new technology for delivering telephone service, known as "IP Telephony" or VOIP (voice over Internet Protocol.)

Competition is strong between Cable and DBS as DBS has added over twenty million subscribers in less than a decade.

The recent alliances between Echostar/DirecTV and the Baby Bells are strong evidence that cable will significantly ramp up its digital telephony effort via VoIP. It is already happening and will ramp faster in 2005.

2. The GAO was asked to examine a sample of markets where cable overbuilders are present and compare competitive conditions with a sample of similar markets in which cable operators do not operate. Senators Kohl and DeWine wanted to know what the effect such cable overbuilders have on cable prices and quality of service. A key question I my mind is whether these overbuilders are offering rates and service that will be able to provide long-term, sustainable competition to both cable incumbents and the nation's two large DBS companies. So how are overbuilders faring in the marketplace today?

Most all cable overbuilders have failed financially. To succeed they have to offer lower prices but if they cut them too much and cable responds they can't get the revenue per customer and penetration rates high enough to make the financial model work. The reason they have failed is that it requires unrealistic capital costs for unrealistic penetration rates. Simply overbuilding is guaranteed high cost without prospect for sufficient risk adjusted return on investment.

Questions from Senator Kohl

1. The FCC's Video Competition Report released in January 2004 shows that the cable industry's earnings continue to rise, and at a very healthy rate. The FCC reported that the cable industry operating cash flow increased more than 25% since 2001, and its cash flow to revenue ratio – which many consider to be a rough approximation of profits – was 41% in 2003. Don't

these high earnings show that the cable industry does not really have to pass along all the programming price increases to consumers?

Cable increases in cash flow come mostly from rate increases, which are a much smaller % than programming costs are increasing, and from new value-added services that are very profitable incrementally.

2. The cable industry often claims that the reason that cable rates are increases are due to increases in the cost of cable programming. Yet a GAO study released in October 2003 found that a substantial portion of the increase in programming rates – as much as half by some estimates -- was recouped by the cable companies in the form of increased local advertising revenues.

(a) What's your response to this finding in the GAO October 2003 Report? Isn't it true that a substantial portion of increased programming costs is recouped by cable operators by increased revenues from local advertising?

Cable runs its businesses holistically, meaning that all costs and revenues are consolidated. In other words, advertising and other revenues help cover all increases in cost.

(b) Do the GAO's findings show that cable operators need not pass along all of programming cost increases to consumers?

Whether or not cable chooses to pass on its costs to consumers is a business decision that cable makes. Both Cable and DBS can raise prices to customers and customers can leave a provider if they do not like the price increase. However, Cable and DBS often do not choose to compete on price, but programming and other features.

3. The GAO report that Senator DeWine and I commissioned found that where the incumbent cable company faced direct competition, prices are generally lower and the quality of service improves. In five of the six market pairs the GAO studied, the consumer's cable bills was lower by between 15 and 41%. An earlier national GAO study found markets with wire-based cable competitors – commonly called "overbuilders" – benefited by prices that were about 15% lower on average.

Do these GAO studies show that the competition that results from the presence of a cable overbuilders results in significant benefits to consumers?

The study and common sense dictate that consumers enjoy better prices and service when there are competitive overbuilders. The problem is the economic sustainability and viability of the overbuilder business model. This is an extremely high fixed cost business.

4. The Cable Act of 1992 requires that programming owned by cable companies be made available to all competitors on the same terms, but it contains an important exception. This requirement only applies to programming delivered by satellite. But programming that is delivered terrestrially is exempt from this program access law. This is what many people call the "terrestrial loophole."

(a) Would an investor be less likely to invest in a cable overbuilder if it appeared likely that the overbuilder would be denied access to important programming (for example, broadcasts of local sports teams) carried by a cable overbuilder?

An overbuilder would be viewed as being at a significant competitive disadvantage if it could not offer a comparable programming package to cable and DBS.

(b) Would it enhance competition to repeal the terrestrial loophole, so that cable companies could not deny to competitors programming in which they have an attributable ownership interest, whether or not that programming is delivered via satellite? Why or why not?

Closing the terrestrial loophole would promote program access which to date has been key in promoting MVPD competition.

5. In your view, has predatory conduct by cable incumbents contributed to the difficulties faced by overbuilders in competing with cable incumbents? Would increased antitrust scrutiny of predatory conduct in the cable industry benefit competition in this industry? In your opinion, why has the Justice Department not brought an antitrust case regarding the allegations of predatory conduct?

Predatory conduct is very fact-specific and investigation-intensive; very hard to speculate without specifics.

6. One of the cable industry's responses to the charge that cable rates are too high is to point to all the new channels that are on cable systems today as compared to ten years ago. But consumer advocates argue that because cable channels are bundled together, and consumers have no choice but to buy all the channels in the bundle, consumers end up paying for channels that they do not watch.

Wouldn't it be better if consumers had a choice of whether to purchase cable channels in the bundle, rather being forced to paying for extra channels which they may never watch?

The issue of a la carte is less an issue of antitrust policy and more one of economic regulation. Does Congress value channel diversity more or consumer choice more? It is a difficult policy trade off; one that Congress was constitutionally made to make.

7. Representatives of the cable television industry argue that we need not worry about competition in the cable industry because cable competes everywhere with satellite television. A few questions -

(a) In your view, does cable and satellite television generally compete on price?

Generally no. but sometimes on the lower end of the market. There are deep equipment discounts though.

(b) Is satellite television a competitor for urban residents who live in an apartment building and are unable to receive satellite signals? For these consumers, isn't cable really the monopoly provider of subscription TV?

Generally yes to both questions.

(c) What about those consumers who want high speed internet services? Is satellite an adequate competitor for these customers?

Satellite high speed is an extremely weak competitor to cable modems and DSL. It is a more than adequate service when none other are available.

(d) Should we be worried that, if present trends continue, the incumbent cable company will be the dominant provider of video and high speed internet services for most consumers?

Factually cable started as the dominant video and high speed provider and will likely continue to be for the next five years at least. This is not to say cable does not have substantial competition, they do.

8. As we all know, there has been a tremendous amount of consolidation among cable, satellite and media companies in recent years. The latest example is Comcast's current efforts to acquire Disney. Last year, News Corporation acquired a controlling interest in DIRECTV. And the year before, Comcast acquired AT&T's cable assets to create the nation's largest cable system. A significant percentage of cable networks are now owned by the large cable companies or the television networks. Indeed, the FCC's recent video competition report found that seven of the top 15 prime time cable networks are owned by cable operators, and the other eight have at least partial ownership by one of the major broadcast networks.

Should we be concerned that all this consolidation makes it difficult for an independent programmer to obtain carriage on cable systems? For example, if Ted Turner was to start CNN today instead of 20 years ago, isn't it true he would find it very difficult to get carried by cable companies?

Yes. The game is national and large scale. Most independents do not have large scale or national reach.

Senator Kohl's Follow-Up Questions for Cable Hearing For Mark Cooper

1. The FCC's Video Competition Report released in January 2004 shows that the cable industry's earnings continue to rise, and at a very healthy rate. The FCC reported that the cable industry operating cash flow increased more than 25% since 2001, and its cash flow to revenue ratio – which many consider to be a rough approximation of profits – was 41% in 2003.

Don't these high earnings show that the cable industry does not really have to pass along all the programming price increases to consumers?

Our analysis shows that the problem is even larger than that. Because revenues from traditional video services (e.g. basic and expanded basic, premium channels and pay per view) have been increasing much more rapidly than costs we believe that the cash flow from these services has doubled. Traditional video services are cross subsidizing the roll out of digital TV and Internet access services. If the cable operators only passed through rising programming costs, rates would be much lower. The solution to rising programming costs is to allow consumers to choose the networks that they want, rather than force them to buy large bundles. If consumers could vote with their feet and not pay for the networks that are too costly, programmers would have to control costs much more aggressively.

2. The cable industry often claims that the reason that cable rates are increasing are increases in the cost of cable programming. Yet a GAO study released in October 2003 found that a substantial portion of the increase in programming rates – as much as half by some estimates -- was recouped by the cable companies in the form of increased local advertising revenues.

(a) Do you agree that a substantial portion of increased programming costs is recouped by cable operators by increased revenues from local advertising?

Yes, the financial figures show this to be the case.

(b) Do the GAO's findings mean that cable operators need not pass along all of programming cost increases to consumers?

Yes.

3. The GAO report that Senator DeWine and I commissioned found that where the incumbent cable company faced direct competition, prices are generally lower and the quality of service improves. In five of the six market pairs the GAO studied, the consumer's cable bills was lower by between 15 and 41%. An earlier national GAO study found markets with wire-based cable competitors – commonly called "overbuilders" – benefited by prices that were about 15% lower on average.

Don't these GAO studies show that the competition that results from the presence of a cable overbuilders results in significant benefits to consumers?

Yes, head-to-head wireline competition is the only factor that disciplines cable operators pricing abuse. The econometric analysis prepared by the Federal Communications Commission supports the same conclusion.

4. In his written testimony for the hearing, Mr. Sachs says that cable overbuilders do not have "an economically sound or sustainable model." What's your response?

There are many different types of overbuilders, including, in particular, municipalities and broadband service providers. The Broadband Service Providers have struggled in significant part because of the anticompetitive tactics of the cable operators, who slow their entry into the market, withhold programming, and price predatorily when new entrants manage to get to market.

5. The Cable Act of 1992 requires that programming owned by cable companies be made available to all competitors on the same terms, but it contains an important exception. This requirement only applies to programming delivered by satellite. But programming that is delivered terrestrially is exempt from this program access law. This is what many people call the "terrestrial loophole."

(a) Would you support repealing the terrestrial loophole, so that cable companies could not deny to competitors any programming in which they have an attributable ownership interest, whether or not that programming is delivered via satellite? Why or why not? Would making cable content owned by cable companies available to all competitors enhance competition?

The terrestrial loophole should be closed, as it is one of the weapons cable operators use to frustrate entry. With the cable operators having become so large and regionally concentrated, the Congress needs to also ban exclusive deals, which deny unaffiliated content to competing video distributors.

(b) If cable overbuilders are not able to get access to essential programming, such as the local news and sports channels carried by your competitors, does this harm your ability to compete?

Yes.

6. In your view, has predatory conduct by cable incumbents contributed to the difficulties faced by overbuilders in competing with cable incumbents? Would increased antitrust scrutiny of predatory conduct in the cable industry benefit competition in this industry? In your opinion, why has the Justice Department not brought an antitrust case regarding the allegations of predatory conduct?

Predatory and other anticompetitive conduct has frustrated entry, but antitrust scrutiny is not enough. By the time antitrust authorities can respond to these practices, the competitors are long gone. The cable industry has extraordinary market power at the point of sale – a seventy-five percent market share. Barriers to entry are unique, including approval of franchise authorities, so that cable operators know far in advance where and when competition is coming. Under these circumstances, Communications Act policies that create procompetitive conditions are necessary. Reactive, antitrust action against anticompetitive behaviors will be insufficient to create an environment in which competition can grow.

7. One of the cable industry's responses to the charge that cable rates are too high is to point to all the new channels that are on cable systems today as compared to ten years ago. But others argue that because cable channels are bundled together, and consumers have no choice but to buy all the channels in the bundle, consumers end up paying for channels that they do not watch.

(a) Wouldn't it be better if consumers had a choice of whether to purchase cable channels in the bundle, rather being forced to paying for extra channels, which they may never watch?

The cost of the bundle has increased five times faster than inflation since the passage of the 1996 Act. The cost of viewing has increase four times faster than the rate of inflation. Consumer choice is the only market-based solution to the anticompetitive and abusive bundling policies of the cable operators.

(b) How do you respond to the argument that if channels were not bundled together, it would be uneconomical for many of the less watched channels to be carried by cable systems?

A policy that allows cable operators to offer bundles, but requires them to also allow consumers to purchase channels on an *a la carte* basis would have no such effect. Most households would still choose bundles because most households are made up of individuals with heterogeneous tastes (men, women, children). A significant minority of households would choose *a la carte* but TV viewing would not decline, because viewing is highly concentrated. About 20 to 30 percent of a network's subscribers account for 80 percent of the viewing. These viewers will certainly be counted among those who choose a network in a bundle or on an *a la carte* basis. Because viewing will not decline sharply, the economics of networks will not be altered.

8. Representatives of the incumbent cable companies have argued that we need not worry about competition in the cable industry because cable competes everywhere with satellite television. A few questions -

(a) In his written testimony at the hearing, Scott Cleland stated that cable and satellite television seldom compete on price. Do you agree?

The econometric evidence presented by both the FCC and the GAO show that satellite does not now and never has disciplined cable pricing. The GAO recently reported a small effect on price that was not statistically significant by usual social science standards.

(b) Is satellite television a competitor for urban residents who live in an apartment building and are unable to receive satellite signals?

Where satellite signals cannot be received, it cannot be a competitor for cable.

(c) What about those consumers who want high speed Internet services? Is satellite an adequate competitor for these customers?

Satellite has failed to develop a technology for delivering high speed Internet at comparable quality and price. Satellite is now jointly marketing its service with DSL.

9. As we all know, there has been a tremendous amount of consolidation among cable, satellite and media companies in recent years. The latest example is Comcast's current efforts to acquire Disney. Last year, News Corporation acquired a controlling interest in DIRECTV. And the year before, Comcast acquired AT&T's cable assets to create the nation's largest cable system. A significant percentage of cable networks are now owned by the large cable companies or the television networks. Indeed, the FCC's recent video competition report found that seven of the top 15 prime time cable networks are owned by cable operators, and the other eight have at least partial ownership by one of the major broadcast networks.

Should we be concerned that all this consolidation makes it difficult for an independent programmer to obtain carriage on cable systems? For example, if Ted Turner was to start CNN today instead of 20 years ago, isn't it true he would find it very difficult to get carried by cable companies?

Yes. The six programmers dominate the video dial, accounting for 75 to 80 percent of prime time viewing, program budgets, writing budgets, and advertising dollars. They bundle their networks into suites of programs and demand carriage in the basic/expanded basic tier. Independent programmers are frozen out in the process.

10. What actions do you recommend that Congress should take to encourage the development of more competition in the cable marketplace?

Close the terrestrial loophole and ban exclusive deals for programming. Require cable operators to give consumers *a la carte* choice. Investigate anticompetitive and predatory practices by the cable industry. Pre-empt state laws that prohibit localities from offering competing cable service.

Insight Communications • 810 Seventh Avenue • New York, NY 10019 • Main 917.286.2300 • Fax 917.286.2301

To: Members of the Senate Judiciary Committee

From: Michael Willner, President & CEO, Insight Communications

Re: Responses to Questions regarding Cable Competition

Date: August 20, 2004

Questions from Senator Specter

(1) It is important that we continue to look for ways to ensure the continued vitality of competition in the multi-channel video programming distribution (MVPD) marketplace. It seems the cable industry now beginning to face real competition from the DBS industry which has grown rapidly since its inception in 1994. It is, in part, due to this competition that cable responded by upgrading its systems, investing over $80 billion to upgrade it digital broadband network systems. And the innovation is just beginning - IP phone service, which promises to create real consumer choice by spurring facilities-based competition in the local telephone market, is right around the corner. Cable companies currently serve 2.5 million residential telephone subscribers using cable lines, and are developing a new technology for delivering telephone service, known as "IP Telephony" or VOIP (voice over Internet Protocol.)

(2) The GAO was asked to examine a sample of markets where cable overbuilders are present and compare competitive conditions with a sample of similar markets in which cable operators do not operate. Senators Kohl and DeWine wanted to know what the effect such cable overbuilders have on cable prices and quality of service. A key question I my mind is whether these overbuilders are offering rates and service that will be able to provide long-term, sustainable competition to both cable incumbents and the nation's two large DBS companies. So how are overbuilders faring in the marketplace today?

Answer:

Only about 400 of the 33,485 cable communities nationwide have two competing franchised wireline providers. Many of these franchised overbuilders, however, have either never deployed and launched their services, launched and failed, or are in danger of bankruptcy. GAO's most recent study of cable overbuilds is based on a tiny percentage of these rare communities. GAO examined only six overbuild communities, and compared them with six other communities that appeared to share certain characteristics with the

overbuild communities but had only a single cable operator. The half dozen overbuilds exemplified many of the difficulties faced by overbuilders, and GAO identified the reasons for these problems

A major reason overbuilders failed was that they simply underestimated the extent to which the marketplace they chose to enter was already fiercely competitive. Overbuilders may have assumed that they could easily and profitably capture customers from incumbent providers with lower prices. But sustainable competition from DBS, which enjoys nationwide economies of scale, had already ensured that cable operators were providing the services that best met consumer demand, at competitive prices. So, overbuilders were caught in an economic bind. To entice customers away from the incumbent, they might have to charge lower prices than the incumbent. But those lower prices were insufficient to cover their costs and investment risk and were economically unsustainable for more than an introductory period.

NCTA has done an analysis which, unlike GAO's most recent study which looked at only six overbuild communities, examined all of the 433 communities with identifiable overbuild systems for which information was obtainable. We confirmed that most of them did, in fact, display anomalous characteristics that explain why their prices (and the prices of competing cable operators in those communities) may, at least temporarily, be lower than prices in other communities.

In fact, 83 of the overbuilds that we identified either have failed and are no longer operational or are not yet operating to any meaningful extent. In a competitive market, companies are expected to charge prices sufficient to cover their costs and to earn a fair, risk-adjusted return on their investment over time. The prices of companies that have failed or are failing obviously cannot be viewed as benchmarks for what competitive systems should charge.

The overbuild landscape is populated with such failed or failing companies. Some, like Altrio, Everest Connections, TOTALink, and WINfirst briefly got started operating overbuild systems before they went bankrupt and/or stopped further construction. Other well-financed companies like Ameritech and GTE constructed and operated systems only to sell them for a small fraction of their original cost. In addition, a large number of overbuilders never even built their systems and launched their services.

Even some of the more established and recognizable overbuild companies (such as Knology, RCN and Starpower Communications) have been on or over the brink of bankruptcy. Even some of the large, established telephone companies that promised to compete with incumbent cable operators in their telephone service areas have ultimately backed away from those plans and have emphasized the marketing of DBS services instead.

Questions from Senator Kohl

1 (a). The FCC's Video Competition Report released in January 2004 shows that the cable industry's earnings continue to rise, and at a very healthy rate. The FCC reported that the cable industry operating cash flow increased more than 25% since 2001, and its cash flow to revenue ratio – which many consider to be a rough approximation of profits – was 41% in 2003. Don't these high earnings show that the cable industry does not really have to pass along all the programming price increases to consumers?

Answer:

While it is true that operating revenues increased since 2001, nearly 60% of the increased revenues have come from two optional services: High-speed Internet and Digital tiers. Basic service and CPST tier revenues increased an average of less than five percent per year between 2001 and 2003.

The FCC's report notes that the cable industry's cash flow to revenue ratio (also know as operating margin) has declined sharply since 1998. Moreover, since the cable industry is a capital intensive business, a cursory look at operating margin does not tell the whole story. A positive operating margin by itself does not mean that an industry is earning profits. In fact, a detailed study of the economics of the cable industry conducted in July 2003 by Bortz Media documented that although the industry did have substantial EBITDA (Earnings before interest, tax, depreciation and amortization) ($106.1 billion) between 1996 and 2002, the cable industry also made massive capital investments ($76.6 billion) and paid nearly $50 billion in interest and therefore had negative free cash flow (-$18.20 billion). Thus, the funds available for distribution to investors and/or debt reduction were negative between 1996 and 2002.

(b) Please describe your company's financial performance, earnings and cash flow over The last five years.

Answer

In order to provide you with comprehensive financial data, we are enclosing our 2003 Annual Report. This report includes a summary statement of consolidated selected financial information for the five years ending December 31, 2003 (page 33). It also includes a five-year overview of operating cash flow and management's discussion and analysis of financial conditions and operational results.

2. The cable industry often claims that cable rates are increasing because of increases in the cost of cable programming. Yet a GAO study released in October 2003 found that a substantial portion of the increase in programming rates – as much as half by some estimates -- was recouped by the cable companies in the form of increased local advertising revenues.

(a) What's your response to this finding in the GAO October 2003 Report? Is it true that a substantial portion of increased programming costs is recouped by cable operators by increased revenues from local advertising?

(b) Do the GAO's findings mean that cable operators need not pass along all of programming cost increases to consumers?

Answer:

While the GAO study found that some portion of the cost of cable programming was, for some cable systems, offset by advertising revenues, it did not find that a substantial portion of the increases in programming rates was recouped by advertising revenues. In fact, while cable operators' revenues from the sale of local advertising have been increasing, they hardly balance increasing programming costs. To the contrary, the gap between programming costs and gross advertising revenues has been grown substantially since 1998:

Year	Increase in Annual License Fees Paid for Basic Cable Programming ($ million)	Increase in Gross Local Advertising Revenues ($ million)
1998	$844	$308
1999	$882	$434
2000	$1,254	$573
2001	$1,350	$16
2002	1,460	$248
2003	$1,411	$315

Source: Kagan World Media, Economics of Basic cable Networks 2004, pp.17-18 and Broadband Cable Financial Databook 2003, p. 19.

In part, the lack of significant growth in advertising revenue may be attributed to the after-effects of September 11, 2001 on advertising and a weakened economy. Nonetheless, the increase in programming license fees widened substantially from 2000 to 2001, and increased again between 2001 and 2002.

(c) Please describe how your company's earnings from local advertising have changed over the last five years.

Answer

Insight's advertising revenue has grown steadily as reflected in the following numbers. These numbers reflect revenue for the full year ($ in 000s):

2003 - $58,832
2002 - $53,415
2001 - $46,907
2000 - $34,934

For more detail, please refer to the Annual Report pages 38 and 40.

(d) What percentage of your costs are due to the costs of acquiring programming?

Answer:

For the year ended December 31, 2003, programming represented 43% of our total costs (excluding depreciation & amortization). In 2002, 2001, and 2000, that number was roughly the same (44%, 45%, and 45%, respectively). More information about these numbers can be found in the risk factors section of the Annual Report. p. 50.)

3. The Cable Act of 1992 requires that programming owned by cable companies be made available to all competitors on the same terms, but it contains an important exception. This requirement only applies to programming delivered by satellite. But programming that is delivered terrestrially is exempt from this program access law. This is what many people call the "terrestrial loophole."

Would you support repealing the terrestrial loophole, so that cable companies could not deny to competitors programming in which they have an attributable ownership interest, whether or not that programming is delivered via satellite? Why or why not? Would making cable content owned by cable companies available to all competitors enhance competition?

Answer:

Insight does not agree that the terrestrial exemption should be classified as a "loophole." To the contrary, Congress struck a deliberate balance in 1992. It sought to ensure that cable's fledgling competitors would have sufficient access to popular programming, while preserving the procompetitive benefits of exclusivity in order to foster new program networks – especially local and regional programming networks.

The current law preserves incentives to engage in the significant financial risk-taking necessary to launch and promote local and regional program services. At the same time, overbuilders can choose from among hundreds of channels of available programming.

There are many reasons why overbuilders have had difficulty competing successfully in a vibrantly competitive video marketplace that now includes not only the incumbent cable operator but also two formidable national DBS providers. But nobody has presented any credible evidence that limited exclusivity for a few channels among the hundreds otherwise available has had the effect of thwarting an overbuilder's ability to compete.

4. One of the cable industry's responses to the charge that cable rates are too high is to point to all the new channels that are on cable systems today as compared to ten years ago. But consumer advocates argue that because cable channels are bundled together, and consumers have no choice but to buy all the channels in the bundle, consumers end up paying for channels that they do not watch.

Wouldn't it be better if consumers had a choice of whether to purchase cable channels in the bundle, rather being forced to paying for extra channels which they may never watch?

Answer:

The first answer is that, more than ever before, consumers do have choices. In addition to the basic and expanded basic tiers, cable consumers may choose to purchase premium movie channels, digital tiers of programming, pay-per-view movies and events, packages of professional baseball, basketball and hockey games and college football games, and video-on-demand movies. In fact, the only programming that is not optional is the basic tier that includes local broadcast stations and public, educational and government access channels. Congress has provided that cable operators (unlike DBS providers) must provide this tier to all cable customers – even though many might otherwise choose to avoid the cost of this tier (which averages just under $13 per month) and rely on an over-the-air antenna to receive local broadcast stations.

Cable customers are not required to purchase the "expanded" basic tier of programming in order to purchase additional premium channels or pay-per-view events. But most subscribers do buy that tier because it typically includes many channels that they highly value and regularly watch. And sometimes they wonder why they cannot purchase only those channels that they want to watch instead of having to buy the entire tier.

It's a fair question – but it presumes that, under an à la carte approach, the same array of services would be available to consumers, and that the price of purchasing only a fraction of the services on the tier would be a corresponding fraction of what the tier currently costs. And, unfortunately, this would not be the case. Requiring all services to be offered on an à la carte basis would add substantial costs to the purchase of such services and, in many cases, would undermine the economic viability of the cable networks that are currently offered on a tiered basis.

First, an à la carte approach requires a set-top box on all subscribers' television sets, because there is no other practical way to ensure that only those services purchased by

the subscriber are viewable to that subscriber. Today, more and more cable customers have set-top boxes in order to receive digital tiers, pay-per-view, and certain premium movie channels. But it is still the case that a majority of customers do not have set-top boxes on even one of their television sets.

For the very large number of customers who rely on "cable-ready" television sets to view basic and expanded basic tier programming, the à la carte approach would require leasing or purchasing addressable set-top boxes for each set in their home, at a cost of approximately $3.25 per box. The average cable household has over 2.5 television sets, so the equipment cost alone could increase the price of the enhanced basic tier by $8.13 – a 23% increase over the average price of $34.52.

But it's not just a question of technology and set-top boxes. The manner in which cable program networks are packaged for purchase by consumers is central to the economic underpinnings of those networks. It affects the price at which they can economically be offered to cable operators and consumers, and, in many cases, it determines whether they can be economically offered at all. This is why most basic networks are offered only on a tiered basis, not only by virtually all cable operators, but by DBS competitors as well. If there were a more attractive economic proposition for gaining customers, surely cable's competitors would have adopted it by now.

Almost all basic cable networks rely on advertising as a source of revenue, along with fees paid by cable operators. Indeed, advertising is typically the larger source of network revenue. While viewership ratings play a role in determining advertising revenues, advertising revenues for basic networks remain based, in substantial part, on the number of potential viewers to whom the service is available. Moreover, it is the opportunity to be sampled by viewers that gives a network the opportunity to build and grow a viewership base that will ultimately produce advertising revenues.

For any basic network that would not be purchased by all current tier subscribers, an à la carte approach reduces the viewership upon which advertising revenues are based. The shortfall would have to be replaced by licensing fees from the cable operators – and for most networks, this is not a viable proposition, since increasing the price of an à la carte channel reduces the number of potential purchasers, which, in turn reduces both advertising and subscriber revenues. There may be no price point at which advertising revenues and subscriber fees are sufficient to sustain a network – whether it is a new network with limited "brand-name" recognition or an established network that appeals to a substantial number of viewers with high-cost programming.

There may be some basic networks for which à la carte might be a viable alternative. But determining when and whether this would be the case through any means other than marketplace research and negotiations between operators and programmers would be a near-impossible task.

Whether offering any particular service on an à la carte basis is economically viable at all, and, if so, whether such an offering has the overall effect of enhancing or reducing

consumer welfare depends on the economics and the demand for that particular service. But requiring all services to be offered on an à la carte basis would clearly have a devastating effect on the value of cable service to virtually all cable subscribers. It would result in the disappearance of many networks that depend on reaching all tier subscribers. And it would almost surely undermine the prospects for any new basic cable networks. It would require customers who currently do not need set-top boxes to receive basic cable networks to lease or purchase such boxes for all their television sets. And, even if networks could survive as à la carte services, the à la carte prices for even a handful of channels would likely exceed the price that subscribers currently pay for the entire tier.

[Please see attached NCTA white paper titled: The Pitfalls of A La Carte: Fewer Choices, Less Diversity, Higher Prices]

5. Representatives of the cable industry have argued that we need not worry about competition in the cable industry because cable competes everywhere with satellite television. A few questions -

(a) In his written testimony at the hearing, Scott Cleland stated that cable and satellite television seldom compete on price. Do you agree? Can you give me any examples where cable and satellite compete on price?

Answer:

While it may be the case that cable and satellite television seldom engage in "price wars," this does not mean that they do not "compete on price." Cable and DBS operators generally charge comparable prices for comparable programming packages and services. There is no reason to believe that these prices are not "competitive" – in other words, no reason to believe that they do not reflect the operators' costs plus a fair return on investment.

The General Accounting Office has found that where there are wireline overbuilders, cable rates tend to be lower than where there are no such overbuilders. But, for a number of reasons which I discussed in my testimony, the prices of overbuilders are often artificially and uneconomically low. Cable operators often have no choice but to meet these lower prices, but this does not mean that such lower rates should be used as a benchmark for determining what all cable operators facing "effective competition" ought to charge.

A better indication of the prices and services that would be offered in a competitive marketplace would be those generally offered by cable operators and satellite providers. As GAO recently found, the two ubiquitously available DBS companies provide "formidable" competition to cable operators nationwide. Where such competition exists, according to GAO, there is typically

a slight reduction in cable rates as well as improved quality and service. In terms of rates, we found that a 10 percent higher DBS penetration rate in a franchise area is associated with a slight rate reduction—about 15 cents per month. Also, in areas where both primary DBS operators provide local broadcast stations, we found that the cable operators offer subscribers approximately 5 percent more cable networks than cable operators in areas where this is not the case. These results indicate that cable operators are responding to DBS competition and the provision of local broadcast stations by lowering rates slightly and improving their quality. During our interviews with cable operators, most operators told us that they responded to DBS competition through one or more of the following strategies: focusing on customer service, providing bundles of services to subscribers, and lowering prices and providing discounts.

(b) Is satellite television a competitor for urban residents who live in an apartment building and are unable to receive satellite signals? For these consumers, isn't cable really the monopoly provider of subscription TV?

Answer:

Obviously, satellite television is not an available choice for those who are unable to receive satellite signals. But this does not mean that such apartment dwellers do not enjoy the benefits of competitive prices and service offerings that result from satellite competition. As discussed above, cable operators and satellite providers compete vigorously by upgrading their facilities, adding new services and enhancing the quality of their services. All these benefits are available to <u>all</u> subscribers of a cable system – including those subscribers who, for various reasons, may not be able to receive satellite service.

Moreover, cable systems do not charge higher prices to those households in their franchise areas that cannot receive satellite service. First of all, the rate regulation provisions of the Communications Act require that cable systems not subject to "effective competition" charge uniform rates throughout their franchise areas. But even apart from this requirement, in order to promote, advertise and market their services effectively in their communities and metropolitan areas, cable systems generally charge the same rates throughout the areas they serve. So, even if satellite service is unavailable to a particular household or a particular building, that household and residents of that building will still pay the same competitive price – and receive the same competitive array of services – as other residents throughout the community.

(c) What about those consumers who want high speed internet services? Is satellite an adequate competitor for these customers?

Answer:

Consumers who want high speed Internet services already enjoy the benefits of vigorous competition between cable operators' "cable modem" service and telephone companies' DSL service. Currently, those two services can be offered more efficiently and at lower prices than satellite-delivered high-speed Internet service. Cable modem service and DSL compete in most communities across the nation – and if not all residents of those communities have <u>both</u> alternatives available, they generally all enjoy the same competitive prices and quality of service (for the same reasons, discussed above, that even those households that cannot receive DBS enjoy the benefits of competition between DBS and cable).

Satellite providers are nevertheless playing a role in making competition between cable modem service and DSL (as well as competition between cable television and DBS) even more intense by joining with telephone companies to offer bundled video, telephone and high-speed Internet services. Cable operators have been effectively offering one-stop shopping and package prices for all three of these services. But while incumbent telephone companies have bundled DSL with their local telephone services, they have not had an effective way of including video in the mix. Entering into agreements with EchoStar and/or DirecTV has enabled Qwest, SBC and BellSouth to add a video component to their bundled offerings so that they, too, can offer all three services to consumer.

6. As we all know, there has been a tremendous amount of consolidation among cable, satellite and media companies in recent years. The latest example is Comcast's current efforts to acquire Disney. Last year, News Corporation acquired a controlling interest in DIRECTV. And the year before, Comcast acquired AT&T's cable assets to create the nation's largest cable system. A significant percentage of cable networks are now owned by the large cable companies or the television networks. Indeed, the FCC's recent video competition report found that seven of the top 15 prime time cable networks are owned by cable operators, and the other eight have at least partial ownership by one of the major broadcast networks.

Should we be concerned that all this consolidation makes it difficult for an independent programmer to obtain carriage on cable systems? For example, if Ted Turner was to start CNN today instead of 20 years ago, isn't it true he would find it very difficult to get carried by cable companies?

Answer:

It is not the case that ownership of cable program networks by cable system operators makes it difficult for an independent programmer to obtain carriage on a cable system. Because they compete vigorously with two national DBS companies and others for

subscribers, cable operators cannot afford to refuse to carry quality programming that would appeal to their customers. But even if that were not the case, the number of channels on cable systems far exceeds the number of program networks owned by any single cable operator.

As a general matter, vertical integration in the cable industry has significantly declined in the last decade. In 1992, half of all cable program networks were vertically integrated with cable system operators. Even then, most of each of those networks' customers were cable operators that did not have an interest in that particular network and would have no reason to carry it instead of an independent programmer. Since 1992 the percentage of programming networks in which cable operators collectively have any ownership interest has dropped sharply to 24%. No single cable operator has a financial interest in more than 10% of the more than 268 national program networks (counting each multiplexed pay-per-view network only once) identified in the Federal Communications Commission's most recent report on competition in the video marketplace. Except for a very small equity piece of The Oxygen Network, Insight does not have ownership in any programming. Thus, it obviously has turned out not to be the case that cable programmers must be vertically integrated or must agree to give cable operators an equity stake in order to compete for carriage on cable systems.

7. Many of us have been very concerned for quite some time about the content of certain programs available to be seen by our children on cable TV. While we understand that legally cable is not held to the same standard as broadcast TV, we are worried that more needs to be done by the cable industry and that some of the cutting edge program on cable isn't good for all ages.

Should there be a family tier of programming on cable? What else can cable do in this area to help parents protect their children?

Answer:

Insight, along with the rest of the cable industry, recognizes and accepts fully its responsibility to do more in this area. And in the last month, the cable industry has stepped forward with new initiatives to meet this responsibility.

First, NCTA is implementing a comprehensive new consumer outreach campaign: "Cable Puts You in Control". This initiative is designed to increase awareness of the tools and resources cable provides, so that families can control programming that comes into their homes and make educated and responsible decisions about television viewing. It offers consumers information about:

- *how to use cable television technology to block channels and programs,*
- *how to use the V-chip and the TV ratings system,*
- *and where to find more information on "media literacy."*

Elements of the initiative include:

- *an information-rich website (www.ControlYourTV.org)*
- *public service announcements that will run on dozens of cable channels;*
- *customer communications materials to help companies discuss parental control issues with your customers and viewers;*
- *and a series of media literacy workshops around the country sponsored by Cable in the Classroom and the National PTA.*
  and remotes.

Second, leading cable companies, including Insight and the other top nine multiple cable system operators, have agreed voluntarily to make channel blocking equipment available upon request at no additional charge to any cable customer that lacks equipment to prevent unwanted programming from being viewed in the home.

Cable customers who subscribe to digital cable tiers, or whose TV's are equipped with V-chips, or who otherwise use a set-top box to receive expanded basic programming already have the technology to block indecent or violent programming at no additional cost. The voluntary agreement by companies that together serve 85% of cable households fills a gap identified by Members of Congress for those cable households that want to block programming which they deem inappropriate for their family's viewing but don't want to pay extra to do so.

Third, in addition to this voluntary commitment by cable operators, NCTA member basic cable programming networks reaffirm their commitment to:

- *apply TV rating and content labels to their programming;*
- *put the appropriate rating icon on-screen at the beginning of every program;*
- *and encode their ratings in programming with codes that can be interpreted by a V-Chip equipped television set.*

Along with the industry-wide, multi-media, consumer education campaign, these actions will assure that parents and caregivers truly have the tools to control what programming their children watch. This means that while some operators might choose to offer a separate tier of "family" programming, such an offering is not necessary in order to enable households to block programming that they might find offensive.

Moreover, mandating the provision of "mini-tiers" that include only a portion of the services that operators might otherwise choose to provide in a single package to their customers would pose many of the same problems as requiring the offering of services on an à la carte basis. As discussed above, Regulating the manner in which cable operators package their services would undermine the economics of basic cable programming and distort the programming marketplace.

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August 3, 2004

The Hon. Mike DeWine
Chairman
Subcommittee on Antitrust, Competition Policy and Consumer Rights
Committee on the Judiciary
U.S. Senate
Washington, DC 20510

The Hon. Herb Kohl
Ranking Member
Subcommittee on Antitrust, Competition Policy and Consumer Rights
Committee on the Judiciary
U.S. Senate
Washington, DC 20510

Dear Chairman DeWine and Ranking Member Kohl:

Thank you for having provided me the opportunity to testify before the Subcommittee on Antitrust, Competition Policy and Consumer Rights in the hearing on *Cable Competition – Increasing Price; Increasing Value?* It was my pleasure to present the views of the National Association of Telecommunications Officers and Advisors (NATOA) on cable competition. I am also pleased to provide the responses below to the questions that were forwarded to NATOA following this hearing.

In response to the question from Senator Specter:

> *The GAO was asked to examine a sample of markets where cable overbuilders are present and compare competitive conditions with a sample of similar markets in which cable operators do not operate. Senators Kohl and DeWine wanted to know what the effect such cable overbuilders have on cable prices and quality of service. A key question in my mind is whether these overbuilders are offering rates and service that will be able to provide long-term, sustainable competition to both cable incumbents and the nation's two large DBS companies. So how are overbuilders faring in the marketplace today?*

Cable overbuilders offer a real alternative to both cable incumbents and the nation's two large DBS companies in terms of price and service, and they should have the ability to provide long-term and sustainable competition in the marketplace.

Overbuilders typically deploy technology at least similar to, if not better than, the incumbent cable operator's network. As technology leads us to a converged world where consumers receive voice, video and data over a single line, competitors with the capacity to offer all three of these services, such as overbuilders, will likely be in the best position to offer competition to an incumbent cable operator.

Incumbent cable operators recognize overbuilders as true competitors. Unlike DBS providers, overbuilders must build out their networks market by market. While I cannot speak to the economies of an overbuilder's business model and deployment strategy, our members have witnessed first hand the response to these deployments by incumbent cable operators, who have attempted to use their size and market power to stifle this competition. In answering the question of how overbuilders are faring in the marketplace today, it is imperative to understand the barriers an incumbent cable operator can create for a new entrant. I would point to the report that I submitted with my testimony, entitled *Anticompetitive Practices by Incumbent Cable Operators*, which helps to illustrate this problem.

In response to the questions from Senator Kohl:

The Cable Act of 1992 requires that programming owned by cable companies be made available to all competitors on the same terms, but it contains an important exception. This requirement only applies to programming delivered by satellite. But an increasing amount of programming – especially local news and sports -- is delivered terrestrially, and is exempt from this program access law. This is what many people call the "terrestrial loophole."

Wouldn't it be a good idea to repeal the terrestrial loophole, so that cable companies could not deny to competitors any programming in which they have an attributable ownership interest, whether or not that programming is delivered via satellite? Why or why not? Wouldn't making cable content owned by cable companies available to all competitors enhance competition?

Congress in the Cable Act of 1992 showed great foresight in requiring programming owned by cable companies to be made available on the same terms to competitors. However, the FCC has found that these provisions only apply to video programming delivered by satellites and does not apply to programming delivered terrestrially. This so called "terrestrial loophole" is problematic in that it provides a sizable advantage for incumbent cable operators who are able to monopolize programming.

I believe Congress should eliminate the terrestrial loophole as it provides a competitive advantage to an established cable operator by denying new entrants content that viewers may want or to which they have become accustomed. This problem becomes even more problematic with the consolidation and clustering of cable systems as incumbent operators are able to tie up even more programming.

The GAO report that Senator DeWine and I commissioned found that where the incumbent cable company faced direct competition, prices are generally lower and the quality of service improves. In five of the six market pairs the GAO studied, the consumer's cable bills were lower by between 15 and 41%. An earlier national GAO study found markets with wire-based cable competitors – commonly called "overbuilders" – benefited by prices that were about 15% lower on average.

Don't these GAO studies show that the competition that results from the presence of a cable overbuilder results in significant benefits to consumers?

The GAO studies do show that competition that results from the presence of a cable overbuilder results in significant benefits to consumers. NATOA believes Congress should make a more in-depth examination of competition in the multi-channel video programming distribution (MVPD) marketplace. If an overbuilder represents a third or fourth competitor in a market, will a fifth and sixth competitor provide even greater benefit to consumers? How many competitors are optimal or possible? The GAO study also shows that competition from DBS providers does not constrain rates. Why?

Competition in the MVPD marketplace, since the passage of the 1992 Cable Act, has been based on a statutory definition of what is considered "effective competition." The determination of "effective competition" was based on one of the following criteria:

1) Fewer than 30 percent of the households in the franchise area subscribe to the cable service of a cable system. (low-penetration test)

2) At least two unaffiliated multichannel video programming distributors each of which offers comparable video programming to at least 50 percent of the households in the franchise area; and the number of households subscribing to programming services offered by multichannel video programming distributors other than the largest multichannel video programming distributor exceeds 15 percent of the households in the franchise area. (competitive provider test)

3) A multichannel video programming distributor operated by the franchising authority for that franchise area offers video programming to at least 50 percent of the households in that franchise area. (municipal test)

Rather than dissect and analyze whether competition had developed or whether this test was functioning in the manner intended, the test was simply reaffirmed in the Telecommunications Act of 1996, with the addition of what is termed the local exchange carrier or LEC test. This test was premised on the assumption that LECs would enter the video market and provide instant competition to cable operators. The LEC test allows an effective competition determination on the basis of a local exchange carrier simply offering comparable video programming other than through DBS to its customers. The test fails to require that a certain percent or even more than two subscribers be served;

only requiring evidence that the LEC had the ability to provide service. The FCC has taken the test even farther and has required only the evidence of an agreement to serve in the future, without any further showing of actual service to any subscriber as satisfying the test.

Congress must examine this notion of "effective competition" and create a definition that reflects a truly competitive market if consumer are expected to receive the benefits of competition.

Based on your experience, what are the main challenges to the ability of cable overbuilders to survive as a viable competitor to the cable incumbents?

I believe the main challenge to the ability of a cable overbuilder to survive as a viable competitor to a cable incumbent is the market power of the cable incumbent. Today, the top six cable operators serve over 56% of MVPD subscribers. Cable operators have worked to consolidate their market power and do not compete with each other. NATOA's members have witnessed, as in part demonstrated by the report submitted with my testimony, *Anticompetitive Practices of Incumbent Cable Operators*, incumbent operators who use predatory pricing and denial of programming to stifle competition. There are also a variety of other practices used by incumbent operators to impede overbuilders, such as refusing to deal with suppliers and contractors that provide service to competitors, using litigation to prevent or delay competition, refusing to carry the advertising of overbuilders and interfering with local franchise processes, etc.

What actions do you recommend that we in Congress take to encourage the development of more competition in the cable marketplace?

First, Congress should reevaluate the statutory definition of "effective competition" in the MVPD marketplace to make it better reflect a truly competitive market, where rates are constrained and consumers have greater choice and better service.

Second, under the existing and any revised test for effective competition that involves a determination as to the provision of DBS service to subscribers as the basis for the finding, it is imperative that all relevant and necessary data be made freely available to the local government, whose rights are affected by such a finding. Currently, a cable operator purchases data from the DBS providers trade association to evidence a petition to the FCC for a finding of effective competition in a market. However, when the local government that would be affected by such a ruling attempts to obtain detailed data to ascertain the validity of the claim, they are either unable to do so, or are only able to do so at a cost that may be prohibitive to that community. The result is the denial of the rights of the local government to ensure their consumers are adequately protected in the absence of truly "effective competition," and the inability of the local government to

overcome the presumptions of the industry and the Commission in making the "effective competition" determination.

Third, Congress should take steps to protect consumers until there is "effective competition." While the efficiencies of a competitive market may eventually provide consumers with better services at lower prices, in the absence of that competition Congress should look to other methods to constrain prices. I believe that a reformed and simplified rate regulation model may provide the most expedient means by which to protect consumers until sufficient competition develops.

Fourth, Congress should take steps to promote additional competition in the MVPD markets until there is "effective competition" in those markets. Consumers will not receive the benefit of true competition unless new competitors are able to enter the MVPD marketplace. Today, overbuilders serve only 1.4 million subscribers or less than 1.5% of the overall MVPD market. Congress should remove barriers to entry that incumbent cable operators create through anti-competitive practices. For example, Congress should end predatory pricing by ensuring uniform rate provisions and ensure local and sports programming is available to competitors by closing the terrestrial loophole.

Again, I thank you for providing me with the opportunity to present NATOA's views on cable competition. NATOA appreciates your continued interest and advocacy on this important issue and we would be happy to provide any further information the Committee may require.

Sincerely,

Coralie Wilson
President

SUBMISSIONS FOR THE RECORD

BEFORE THE
UNITED STATES SENATE
COMMITTEE ON THE JUDICIARY
SUBCOMMITTEE ON ANTITRUST, COMPETITION
AND BUSINESS AND CONSUMER RIGHTS

HEARING ON

"CABLE COMPETITION – INCREASING PRICE; INCREASING VALUE?"

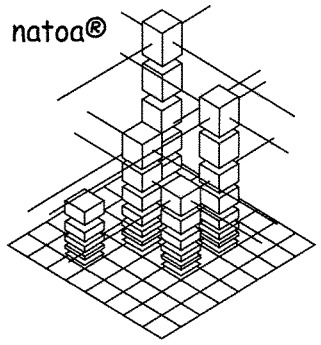
FEBRUARY 11, 2004

DIRKSON S-226

ATTACHMENT TO TESTIMONY OF
CORALIE WILSON, PRESIDENT

THE
NATIONAL ASSOCIATION OF TELECOMMUNICATIONS
OFFICERS AND ADVISORS

THE NATIONAL ASSOCIATION OF TELECOMMUNICATIONS OFFICERS AND ADVISORS



REPORT ON

ANTICOMPETITIVE PRACTICES BY INCUMBENT CABLE OPERATORS

Prepared at the request of the NATOA Board of Directors

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Introduction by NATOA: This report was originally prepared at the request of the National Association of Telecommunications Officers and Advisors' Board of Directors. The report was presented to the Board of Directors in March 2003. The report has been used to supplement our understanding of some obstacles to meaningful competition in our communities, and to better ascertain whether there are actions that may be taken by local government to enhance the ability of competition to take hold and flourish. Some portions of the report relating to advice or strategy have been removed prior to its distribution beyond the leadership of the Board. While NATOA has agreed to make the content of the analysis available for further consideration, NATOA specifically cautions the reader that examples contained in the report that imply anticompetitive behavior are the result of media reports, direct member or local government reports or public information. Incumbent providers have not been asked by NATOA to specifically respond to such allegations. Except as indicated herein, examples have not been further tested, verified or otherwise subjected to scrutiny by NATOA. Further, the reader is encouraged to verify accuracy of any information which may have changed as a result of the passage of time.

OVERVIEW

In recent months, the Federal Communications Commission ("Commission" or "FCC") has expressed increasing alarm about anticompetitive behavior by some of the nation's largest cable operators. To date, however, the Commission has not taken any concrete steps to address this issue. To the contrary, and perhaps unintentionally, the Commission has issued a number of piecemeal decisions and orders that have exacerbated the problem.

At the request of NATOA's Board of Directors, the Baller Herbst Law Group has gathered a substantial amount of information about the anticompetitive practices of the major multi-system operators (MSOs). We obtained much of this information from members of NATOA, the American Public Power Association (APPA), and the Broadband Service Providers Association (BSPA).[1] We also reviewed pleadings and rulings in cases before the FCC, the DOJ, the Federal Trade Commission (FTC) and the courts; federal and state agency reports; law review articles; legal treatises; newspapers and magazines; and various other sources.

Our research focused on predatory pricing, rate discrimination, denial of access to programming, exclusion of competitors from multiple dwelling units (MDUs), threats not to do business with contractors and suppliers that wanted to serve new competitors, and an assortment of other unfair business practices. Our research confirmed that anticompetitive behavior by the major MSOs is a significant and growing threat to competition in the cable industry.

ANALYSIS

In Section I below, we begin with an overview of the undisputed fact that healthy competition in the cable industry furthers the public interest. In Section II we discuss the specific anticompetitive practices of cable MSOs.

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[1] BSPA is the trade association for the private-sector overbuilders, including RCN, Knology, Altrio, Everest and others.

I. THE BENEFITS OF COMPETITION

According to the FCC, there are a total of 9,667 cable systems in the United States, and of these, only 64 faced competition from public or private overbuilders as of November 2002.[2] Where overbuilds have occurred, they have greatly benefited consumers. According to the FCC, "[a]vailable evidence indicates that when an incumbent cable operator faces 'effective competition,' as defined by the Communications Act, it responds in a variety of ways, including lowering prices or adding channels without changing the monthly rate, as well as improving customer service and adding new services such as interactive programming."[3]

More specifically, in each of its last two reports on cable pricing, the FCC has found that consumers in competitive markets pay cable rates that average 6.3 percent lower than cable rates in non-competitive markets.[4] In fact, this so-called "competitive differential" is likely to be significantly higher than 6.3 percent because, as discussed more fully below, the FCC's flawed definition of "effective competition" results in the inclusion of rate differentials from many markets in which no meaningful competition exists.

The average system capacity of incumbent cable systems is 14 MHz greater in competitive markets than in non-competitive markets. *Ninth Annual Video Competition Report* at ¶24, Table 3. Incumbents in competitive markets are 5.2 percent more likely than incumbents in non-competitive markets to have upgraded their systems to 750 MHz or higher. *Id.* Similarly, the average number of channels in competitive markets is greater than in non-competitive markets (83.3 to 81.7). *Id.*

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2 *Applications for Consent to the Transfer of Control of Licenses from Comcast Corporation and AT&T Corp., to AT&T Comcast Corporation,* MB Docket No. 02-70, *Memorandum Opinion and Order at* ¶ 90 n.241 (released November 14, 2002) ("*AT&T/Comcast Merger Approval Order*"). The FCC's data may be significantly understated. For example, APPA reports that, as of the end of 2002, there were at least 105 cable systems operated by public power utilities alone. http://www.appanet.org/pdfreq.cfm?PATH_INFO=/legislative regulatory/broadband/Telecom%20Fact%20Sheet_1-2003.pdf&VARACTION=GO. As of December 2001, members of BSPA had 22 million households under franchise, over one million current subscribers, and more than 29,000 miles of constructed broadband network in twenty-four states and the District of Columbia. *BSPA Comments to FCC,* CS Docket No. 01-290 at 1 and n.1 (filed December 3, 2001).

3 *In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming,* Ninth Annual Report FCC 02-338 (released December 31, 2002) (hereafter "*Ninth Annual Video Competition Report*") at ¶8.

4 *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: Report on Cable Industry Prices,* FCC 02-107 (released April 4, 2002) ("*Cable Prices Report*") at ¶8.

Furthermore, the FCC has also found that incumbent cable operators are more price-sensitive to competition from wireline overbuilders than they are to satellite competitors:

> In those areas where a cable operator faces effective competition from a wireline overbuilder (i.e., where a finding of effective competition was based on the [Local Exchange Carrier] LEC test or the wireline portion of the overbuild test), we found that operators tend to offer more channels at a lower rate. In the few areas where the Commission has made a finding of effective competition as a result of [Direct Broadcast Satellite] DBS penetration, *we found that the presence of DBS competition had no statistically significant effect on the demand for cable service or on cable rates.*[5]

Healthy competition in the cable industry undisputedly furthers the public interest. Several of the large MSOs, however, are less than keen on it. They possess both the ability and the natural inclination to eliminate nascent competition, and, as discussed in the following section, they have employed a variety of anticompetitive tactics to do so.

II. ANTICOMPETITIVE PRACTICES OF MSOs

When faced with competition from overbuilders, several of the largest incumbent cable operators have resorted to anticompetitive practices of various kinds. In this section, we discuss the major categories of anticompetitive behavior that our research has disclosed -- predatory pricing, rate discrimination, denial of access to programming, unfair conduct concerning access to MDUs, and other unfair competitive practices.

A. Predatory Pricing

1. Predatory pricing under the federal antitrust laws

a. The Sherman Act

Section 2 of the Sherman Antitrust Act, 15 U.S.C. § 2, provides that:

> Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not

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[5] *Cable Prices Report* at ¶10 (emphasis added). The FCC noted, however, "because of the specific nature of the sample, no general conclusions may be drawn from this fact." *Id.* Earlier, a report of the General Accounting Office had reached the same conclusion for the year 1998. *The Effect of Competition from Satellite Providers* on Cable Rates, United States General Accounting Office (July 2000). In fact, the GAO found that "greater DBS penetration was statistically associated with somewhat higher cable rates." *Id.* at 6.

> exceeding $10,000,000 if a corporation, or, if any other person, $350,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.

Predatory pricing is one of the many ways in which a would-be monopolist can violate Section 2 of the Sherman Act.[6] As the FCC has observed, "[p]redatory pricing involves 'deliberately pricing below cost to drive out rivals and raising the price to the monopoly level after their exit.' Thus, the offense of predatory pricing has two elements: a pricing element and a subsequent recoupment element." *Panamsat v. Comcast,* 12 FCC Rcd 6952, FCC 97-172 (released May 20, 1997), quoting *Price Cap Performance Review for Local Exchange Carriers,* 11 FCC Rcd 858, 870-871 (1995).

In *Brooke Group Ltd v. Brown & Williamson Tobacco Corporation*, 509 U.S. 209 (1993), the United States Supreme Court said of the pricing element that "a plaintiff seeking to establish competitive injury resulting from a rival's low prices must prove that the prices complained of are below an appropriate measure of its rival's costs. ... [O]nly below-cost prices should suffice, and we have rejected elsewhere the notion that above-cost prices that are below general market levels or the costs of a firm's competitors inflict injury to competition cognizable under the antitrust laws." *Id.* at 223 (citations omitted).

In the course of spelling out how it would determine whether discounts to multiple dwelling units (MDUs) were predatory, the FCC noted that it was required to apply the teaching of *Brooke Group*.[7] With regard to the below-cost pricing element, the FCC said that "we will consider whether a cable operator's price to an MDU recovers at least the incremental costs of serving that MDU, including any new costs from constructing or upgrading its physical facilities in order to offer the bulk service agreed to with the building's owner or manager, and whether the cable operator has a reasonable prospect of recouping its investment in below cost prices in the MDU."[8]

The recoupment element, the Supreme Court continued in *Brooke Group*, is satisfied when the following conditions are met:

> For recoupment to occur, below-cost pricing must be capable, as a threshold matter, of producing the intended effects on the firm's rivals, whether driving

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6 In other contexts, plaintiffs can also claim anticompetitive predation under the Robinson-Patman Act, 15 U.S.C. § 13(a) (as amended). The Robinson-Patman Act applies only to goods and commodities, however, and cable service does not qualify as such.

7 *In the Matter of Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996*, FCC 99-57, *Report and Order*, 1999 WL 5296 at ¶ 111 (rel. March 25, 1999) ("*Telecommunications Act Implementation Order*"). As discussed more fully below, the 1996 Act expressly exempted non-predatory bulk discounts to MDUs from the uniform rate requirement of Section 623(d) of the Communications Act, 47 U.S.C. § 543(d).

8 *Telecommunications Act Implementation Order* at ¶ 108.

them from the market or, as was alleged to be the goal here, causing them to raise their prices to supracompetitive levels within a disciplined oligopoly. This requires an understanding of the extent and duration of the alleged predation, the relative financial strength of the predator and its intended victim, and their respective incentives and will. The inquiry is whether, given the aggregate losses caused by the below-cost pricing, the intended target would likely succumb.

If circumstances indicate that below-cost pricing could likely produce its intended effect on the target, there is still the further question whether it would likely injure competition in the relevant market. The plaintiff must demonstrate that there is a likelihood that the predatory scheme alleged would cause a rise in prices above a competitive level that would be sufficient to compensate for the amounts expended on the predation, including the time value of the money invested in it. As we have observed on a prior occasion, "[i]n order to recoup their losses, [predators] must obtain enough market power to set higher than competitive prices, and then must sustain those prices long enough to earn in excess profits what they earlier gave up in below-cost prices."

Evidence of below-cost pricing is not, alone, sufficient to permit an inference of probable recoupment and injury to competition. Determining whether recoupment of predatory losses is likely requires an estimate of the cost of the alleged predation and a close analysis of both the scheme alleged by the plaintiff and the structure and conditions of the relevant market. If market circumstances or deficiencies in proof would bar a reasonable jury from finding that the scheme alleged would likely result in sustained supracompetitive pricing, the plaintiff's case has failed. In certain situations - for example, where the market is highly diffuse and competitive, or where new entry is easy, or the defendant lacks adequate excess capacity to absorb the market shares of his rivals and cannot quickly create or purchase new capacity - summary disposition of the case is appropriate.

Brooke Group, 509 U.S. at 225-26.

b. The Federal Trade Commission Act

Predatory pricing can also be a violation of Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45(a)(2), which empowers the Federal Trade Commission (FTC) "to prevent persons, partnerships, or corporations ... from using unfair methods of competition in or affecting commerce and unfair or deceptive acts or practices in or affecting commerce." "Unfair" practices are defined to mean those that "cause[] or [are] likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition." 15 U.S.C. § 45(n).

In particular, the courts have found that selling at unreasonably low prices with the intent to eliminate competition is an "unfair method of competition" and that 15 U.S.C. § 45 empowers the FTC to eliminate such practices in their incipiency. *See, e.g., FTC v. Hunt Foods & Industries, Inc.*, 178 F. Supp. 448, 454 n.19 (S.D. Cal. 1959), aff'd, sub *nom. Hunt Foods & Industries, Inc. v. FTC*, 286 F.2d 803 (9th Cir. 1959), *cert. denied*, 365 U.S. 877 (1960).

According to the FTC's website, however, the Commission "has not found predatory pricing violations in recent years, but it examines potential violations very carefully and maintains a close watch for other kinds of tactics -- like raising competitors' costs -- that may disadvantage rivals."[9]

2. Predatory pricing under the federal communications laws

Section 201(b) of Title II of the Communications Act, which applies to common carriers, prohibits "unjust or unreasonable" rates.[10] For the purposes of Title II, the FCC has determined that predatory pricing is "unjust and unreasonable" and is therefore prohibited by Section 201(b).[11] But even with this statutory basis for agency action against predatory pricing by common carriers, the FCC has bound itself to the fact-intensive predatory pricing analysis established by the antitrust acts and the U.S. Supreme Court (as described above).[12]

Cable operators are not subject to the Act's common carrier requirements, including Section 201(b).[13] Because there is no provision analogous to Section 201(b) in Title VI of the Communications Act (the "Cable Act"), overbuilders that have been victimized by predatory pricing have sought remedies elsewhere. For example, in *In the Matter of Armstrong Communications, Inc.*, 2001 WL 43378, the complainant, Citizens Cable, pointed to Section 623(d), which provides as follows:

> UNIFORM RATE STRUCTURE REQUIRED -- A cable operator shall have a rate structure, for the provision of cable service, that is uniform throughout the geographic area in which cable service is provided over its cable system. This subsection does not apply to (1) a cable operator with respect to the provision of cable service over its cable system in any geographic area in which the video programming services offered by the operator in that area are subject to effective competition, or (2) any video programming offered on a per channel or per program basis. Bulk discounts to multiple dwelling units shall not be subject to this subsection, except that a cable operator of a cable system that is not subject to

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9 http://www.ftc.gov/bc/compguide/maintain.htm.

10 47 U.S.C. § 201(b) states that "[a]ll charges, practices, classifications, and regulations for and in connection with such communication service, shall be just and reasonable, and any such charge, practice, classification, or regulation that is unjust or unreasonable is declared to be unlawful . . .."

11 *In the Matter of Panamsat Corp. v. Comcast Corp.*, Dkt. No. E-96-21, *Memorandum Decision and Order* ¶ 16 (rel. May 20, 1997), citing *Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor*, 77 FCC 2d 308, 334 (1979).

12 *Panamsat* at ¶¶ 16-20.

13 Title 47 U.S.C. § 541(c) provides that "[a]ny cable system shall not be subject to regulation as a common carrier or utility by reason of providing any cable service."

> effective competition may not charge predatory prices to a multiple dwelling unit. Upon a prima facie showing by a complainant that there are reasonable grounds to believe that the discounted price is predatory, the cable system shall have the burden of showing that its discounted price is not predatory.

The FCC rejected Citizens Cable's claim, finding that the Commission lacks authority under Section 623(d) or its implementing regulations to remedy pricing practices that would be considered "predatory" under the antitrust laws:

> Citizens Cable also alleges that Armstrong is engaging in predatory pricing through its non-uniform pricing and asks that the uniform rate requirement be enforced for this reason. Citizens Cable Ex Parte Presentation at 5-6. Section 623(d) of the Communications Act, 47 U.S.C. § 543(d), exempts bulk discounts to multiple dwelling units from the uniform rate requirement but provides that cable systems not subject to effective competition may not charge predatory prices to a multiple dwelling unit. It does not provide for broader Commission review of allegations of predatory pricing. Section 76.984 on which Citizens Cable relies implements this statutory provision. It does not provide for the broader antitrust review of Armstrong's rates that Citizens Cable seeks.

Armstrong, 2001 WL 43378, ¶ 10 n.34.[14]

Another potential vehicle for the FCC to act against predatory pricing is Section 628(b), one of the programming access provisions that Congress enacted as part of the Cable Act amendments of 1992. Section 628(b) provides that:

> It shall be unlawful for a cable operator, a satellite cable programming vendor in which a cable operator has an attributable interest, or a satellite broadcast programming vendor to engage in unfair methods of competition or unfair or

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[14] In determining whether predatory pricing is occurring at MDUs, the FCC follows *Brooke Group*. *In the Matter of Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996, Report and Order*, 14 FCC Rcd 5296, 1999 WL 5296 at ¶ 111 (rel. March 29, 1999) ("*Telecommunications Act Implementation Order*"). With regard to the below-cost element, the FCC considers "whether a cable operator's price to an MDU recovers at least the incremental costs of serving that MDU, including any new costs from constructing or upgrading its physical facilities in order to offer the bulk service agreed to with the building's owner or manager, and whether the cable operator has a reasonable prospect of recouping its investment in below cost prices in the MDU." *Id.* at ¶ 108. For the recoupment element, the FCC focuses on whether the complainant has made "a plausible theory showing that the cable operator has a reasonable prospect of ultimately recouping its investment in below-cost prices, including the time value of the money invested in below-cost pricing ... from future price increases in the same MDU." *Id.* at 111.

> deceptive acts or practices, the purpose or effect of which is to hinder significantly or to prevent any multichannel video programming distributor from providing satellite cable programming or satellite broadcast programming to subscribers or consumers."

Although the Commission has thus far applied Section 628(b) only to unfair methods of competition "in the sale of satellite cable and satellite broadcast programming," *see, e.g., Cross Country Cable, Inc. v. C-TEC Cable Systems of Michigan, Inc.*, ¶ 16, 12 FCC Rcd 2538, 1997 WL 90991, there is nothing in the language or legislative history of Section 628(b) that compels such a narrowing construction. To the contrary, when a cable operator attempts to drive a competitor out of the market, the cable operator's purpose is "to hinder significantly or to prevent [a] multichannel video programming distributor from providing satellite cable programming or satellite broadcast programming to subscribers or consumers." Moreover, in implementing Section 628(b) of the Act, the Commission has specifically recognized the potential expansive breadth of this provision, stating:

> This provision is a clear repository of Commission jurisdiction to adopt additional rules or to take additional actions to accomplish the statutory objectives should additional types of conduct emerge as barriers to competition and obstacles to the broader distribution of satellite cable and broadcast video programming. In this regard it is worth emphasizing that the language of 628(b) applies on its face to all cable operators.

In the Matter of Implementation of Sections 12 and 19 of the Cable Television Consumer Protection and Competition Act of 1992, Development of Competition and Diversity in Video Programming Distribution and Carriage, 8 FCC Rcd. 3359 (April 1, 1993).

In summary, while one could reasonably argue that the FCC has sufficient existing authority to take action against predatory pricing in the cable industry, the FCC appears to doubt that it has the power to do so.

3. Evidence of predatory pricing by MSOs

Michael Goodman, an analyst with The Yankee Group, said in early 2002: "The FCC says it wants competition. This is what competition is. You try to win my subscribers. I try to win them back. This is the way the game is played." (*Austin American-Statesman*, February 7, 2002, at A1). Mr. Goodman's simple statement sounds great for consumers – surely, consumers must benefit from good, healthy competition, even if – or especially if – it involves targeted win-back schemes.

In the long run, however, consumers do not benefit from win-back schemes of the kind that the several major incumbent cable operators are using today. In such schemes, the operator uses profits from non-competitive markets to subsidize below-cost prices in markets where they face head-to-head competition. The incumbent does not offer these prices to everyone, but only to subscribers who have already gone over to a competitive overbuilder or are in the process of doing so. Nor does the incumbent make these prices available only as a short-term promotion. Rather, it leaves the discounted prices in place, or extends them repeatedly, in the hope that they will drive the overbuilder out of the market and leave the MSO with no effective deterrent to

raising prices to monopoly levels. Such behavior not only harms the overbuilder that is directly under attack, but it also sends a chilling message to potential competitors and to financial markets – i.e., "Don't even think about competing with us because we can do this whenever and wherever we want!" In the end, the ultimate victim is the public interest in robust competition.

Take, for example, the conduct of Charter Communications Company in Scottsboro, Alabama, where it competes with the municipal cable system operated by the Scottsboro Electric Plant Board. In 2000, while charging $72.99 to $79.99 a month for approximately 150 premium channels in nearby communities in which it faced no competition, Charter offered Scottsboro's customers 200 premium channels for $19.95 to $24.95 a month, depending on the time of acceptance. Later, Charter sweetened its offer by adding a free month of service, $200 cash for switching to Charter's cable service, an additional $200 cash for switching to Charter's high speed Internet service, and amnesty on past debts owed to Charter or its predecessor. Through these tactics, Charter has to date lured away more than a third of Scottsboro's subscribers.

Scottsboro called Charter's conduct to the FCC's attention in August 2001.[15] Using Charter's own data in its latest 10Q Report to the Securities and Exchange Commission, Scottsboro showed that Charter's monthly rate of $24.95 to Scottsboro's subscribers was $0.87 less than its nationwide average monthly operating expense of $25.82 per subscriber. Adding to this loss the economic effects of Charter's payment of $200 to each Scottsboro subscriber who switched to Charter's cable television service, Scottsboro showed that **Charter was losing at least $210 a year on every cable subscriber that it snatched from Scottsboro**. Scottsboro's estimates were highly conservative because they did not take into account Charter's losses of $60 a year on subscribers who paid $19.95 rather than $24.95 a month, Charter's losses of at least $110 a year on each Scottsboro subscriber who switched to Charter's Internet service, and Charter's losses in its "amnesty" program.

Subsequently, Scottsboro furnished the FCC a more detailed analysis focusing Charter's programming costs for the 200 premium services that it was offering to Scottsboro's subscribers.[16] This analysis showed that Charter was paying an average of $36.85 per month just for the programming that it was selling for $24.95 or $19.95 a month. The $36.85 a month did not include Charter's capital and other operating costs, its payments of up to $400 each to induce Scottsboro's subscribers to switch to Charter's cable and Internet service, and its losses of principal and interest in its amnesty program. **In short, on just its programming costs, Charter was losing between $11.90 and $16.90 a month, or $142.8 to $202.80 a year, on every cable subscriber that it took from Scottsboro.**

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15 Scottsboro's and Charter's comments are available through the FCC's Electronic Comment Filing System, http://gullfoss2.fcc.gov/prod/ecfs/comsrch_v2.cgi, by typing "01-129" into the "Proceeding" block.

16 Lacking Charter's actual cost data, Scottsboro used the rates that the National Cable Television Cooperative was charging its 13 million subscribers for similar premium services. Since Charter had 6.3 - 7.0 million subscribers, its costs were not likely to be lower than the costs of NCTC's members, including Scottsboro.

After Scottsboro filed its evidence, a private-sector overbuilder – Knology, Inc. – filed comments showing that Charter was engaging in similar anticompetitive tactics in markets in which Knology was seeking to compete. The FCC gave Charter every opportunity to respond to Scottsboro's and Knology's evidence. In fact, the FCC expressly asked Charter to respond in detail. But Charter never contested the facts that Scottsboro and Knology presented. Rather, Charter claimed that its tactics were "simply competition" and that the FCC had no authority to do anything to stop them.[17]

In paragraphs 196-209 of its *Eighth Annual Video Competition Report*,[18] the FCC discussed at length the comments that it had received from Scottsboro, Knology and Charter, and it concluded,

> As the cases presented above suggest, subscribers usually benefit from "head-to-head" competition. In communities where "head-to-head" competition has been sustained for a long period of time, customers generally receive lower monthly rates and better service, while operators generally enjoy higher penetration rates and lower churn rates. Commenters report that, however, in some cases, particularly where a new entrant may appear vulnerable for financial or other reasons, the initial response of a large incumbent MSO to competition may be motivated by anticompetitive animus rather than legitimate business concerns. Further, commenters informed us that, because of the difficulty and cost of pursuing antitrust remedies, it may be that the target of anticompetitive conduct is without practical remedy.
>
> The allegations made in the comments of Scottsboro and Knology highlight the difficulties of new entrants that, for whatever reason, are capable of competing only within a confined geographic region. The vast resources of a large MSO may simply prove too much if brought to bear in a targeted fashion against a single system entrant. Moreover, we are concerned about the signal such targeting may send to others who would compete in the MVPD [multichannel video programming distributor] market, and particularly to the financial markets to which a new entrant may well be dependent for resources. However, it is not clear that we have specific statutory authority to address these

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17 When Scottsboro presented these facts to the FCC, Charter did not dispute them, but responded that this was "simply competition" that benefits consumers and that the FCC has no authority to do anything about Charter's practices. Scottsboro's and Charter's comments are available through the FCC's Electronic Comment Filing System, http://gullfoss2.fcc.gov/prod/ecfs/comsrch_v2.cgi, by typing "01-129" into the "Proceeding" block. The FCC's response appears in *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming,* Eighth Annual Report FCC 01-389 (released January 14, 2002) (hereafter "*Eighth Annual Video Competition Report*") ¶¶196-209.

18 *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming,* Eighth Annual Report FCC 01-389 (released January 14, 2002) (hereafter "*Eighth Annual Video Competition Report*").

> kinds of problems directly. There has been some suggestion that our authority to prohibit anticompetitive acts or unfair practices under section 628 of the Act would reach targeted and predatory competitive responses. Alternatively, it may be that we would have to seek additional authority from Congress in order to combat such practices, which tend to limit competition and discourage new entry.

Eighth Annual Video Competition Report at ¶¶208-09.

Predatory pricing also emerged as a significant issue in the AT&T Broadband/Comcast merger. In particular, WideOpenWest, a private-sector overbuilder, showed that Comcast regularly offers unpublished, targeted discounts to attract or hold on subscribers. Comcast and AT&T tried to downplay these practices as "healthy competition," but the FCC was not persuaded:

> Although the Applicants deny that they have engaged in predatory pricing behavior, their representations leave open the substantial possibility that the Applicant may well have engaged in questionable marketing tactics and targeted discounts designed to eliminate MVPD competition and that these practices ultimately may harm consumers.
>
> We also disagree with Applicants' claim that targeted discounts merely reflect healthy competition; in fact, although targeted pricing between and among established competitors of relatively equal market power may be procompetitive, targeted pricing discounts by an established incumbent with dominant market power may be used to eliminate nascent competitors and stifle competitive entry. . . .
>
> We do not agree with the Applicants that targeted pricing enhances competition. To the contrary, *targeted pricing may keep prices artificially high for consumers who do not have overbuilders operating in their areas because of the overbuilders' inability to compete against an incumbent who uses such strategies. Thus, we believe that targeted pricing as described in this record could harm MVPD competition.* Nevertheless, we are unable to conclude that this transaction will aggravate the problem. Accordingly, we decline to impose any conditions on the merger that would require the merged entity to post its rates and promotions on its website or otherwise facilitate the dissemination of pricing and discount information within local franchise areas.
>
> *Mounting consumer frustration regarding secretive pricing practices and the threat that such practices pose to competition in this market suggest, however, that regulatory intervention may be required either at the local, state, or federal level.* We take cognizance of the fact that the DOJ may have begun an investigation into this behavior, and that local franchise authorities have imposed requirements of the type RCN advocates to prevent such conduct. The Media Bureau and Enforcement Bureau currently are reviewing complaints by overbuilders concerning these practices. We will continue to monitor allegations of targeted pricing closely and address specific abuses on a case-by-case basis.

AT&T/Comcast Merger Approval Order ¶¶ 33-34 (emphasis added) (footnotes omitted).

In Appendix A, we document numerous other examples of predatory pricing by the nation's largest incumbent cable operators. Given the nature of our information gathering, we cannot guarantee that all of the information in Appendix A is completely accurate or current. Nor have we subjected these cases to detailed analyses of the kind that was presented to the FCC for Scottsboro. Still, given the sheer quantity of the information available, it seems beyond doubt that predatory pricing is a widespread phenomenon across the United States. At a minimum, this information warrants further investigation.

B. Rate discrimination

In the previous section, we focused on "predatory pricing" as formally defined in the antitrust laws. In this section, we turn to rate discrimination, a practice that can be anticompetitive and contrary to the public interest even if the perpetrator does not charge below-cost rates or have a reasonable probability of its recouping losses after driving its competitor out of the market.

In the cable industry today, several major MSOs are practicing targeted rate discrimination through what they call euphemistically "win-back" programs. These programs have a common and critical feature – the MSO does not offer its own subscribers the same special deals that it offers to subscribers who have transferred, or are threatening to transfer, their business to an overbuilder. If the MSOs had to offer the same deals to all of their own subscribers, they might well abandon this form of anticompetitive behavior.

For example, assume that an incumbent has 10,000 subscribers in a franchising area and that its nascent competitor has 1,000. Assume further that the incumbent estimates that offering the competitor's subscribers a discount of $20 a month for a year would attract 25 percent of the competitor's subscribers and significantly impair the competitor's business plan. The discount would cost the incumbent $60,000 ($20/month x 12 months x 25% x 1,000 subscribers). Even if the $60,000 was wholly or partially below cost, the incumbent would probably be willing to pay that price in return for the freedom to charge whatever it wanted *to all 11,000 subscribers* in the market after driving its competitor out. If the incumbent had to offer the same deal to all of its subscribers, however, doing so would cost it an additional $2,400,000 ($20/month x 12 months x 10,000 subscribers). In the latter case, the incumbent would probably decide that crushing its competitor was not worth the cost.

It was precisely for this reason that Congress enacted the uniform rate requirement in Section 623(d) of the Communications Act, 47 U.S.C. § 521(d), as part of the Cable Television Consumer Protection and Competition Act of 1992.[19] According to the FCC, the purpose of Section 623(d) was "'to prevent cable operators from having different rate structures in different parts of one cable franchise ... [and] to prevent cable operators from dropping the rates in one portion of a franchise area to undercut a competitor temporarily.'"[20]

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19 Section 623(d) is quoted in full at page 8 above.

20 *Telecommunications Act Implementation Order* at ¶ 95, quoting S. Rep. No. 92, 102d Cong, 1st Sess. 76 (1991).

In the Telecommunications Act of 1996, however, acting on the assumption that the new Act would rapidly bring meaningful competition to the cable industry, Congress amended uniform rate requirement in Section 623(d) to add the following "effective competition" exception:

> This subsection does not apply to (1) a cable operator with respect to the provision of cable service over its cable system in any geographic area in which the video programming services offered by the operator in that area are subject to effective competition, or (2) any video programming offered on a per channel or per program basis. Bulk discounts to multiple dwelling units shall not be subject to this subsection, except that a cable operator of a cable system that is not subject to effective competition may not charge predatory prices to a multiple dwelling unit. Upon a prima facie showing by a complainant that there are reasonable grounds to believe that the discounted price is predatory, the cable system shall have the burden of showing that its discounted price is not predatory.

While an "effective competition" exception may sound reasonable in theory, the FCC has interpreted "effective competition" in ways that render that term all but useless in identifying markets in which true competition can fairly be said to exist. To the contrary, the FCC's interpretations have opened the door to precisely the kinds of anticompetitive behavior that Congress sought to prevent by enacting the uniform rate provision.

Specifically, in Section 623(l) of the Telecommunications Act, 47 U.S.C. §543(l), Congress specified four criteria for determining where "effective competition" exists:

> (A) fewer than 30 percent of the households in the franchise area subscribe to the cable service of a cable system;
>
> (B) the franchise area is--
>
> (i) served by at least two unaffiliated multichannel video programming distributors each of which offers comparable video programming to at least 50 percent of the households in the franchise area; and
>
> (ii) the number of households subscribing to programming services offered by multichannel video programming distributors other than the largest multichannel video programming distributor exceeds 15 percent of the households in the franchise area;
>
> (C) a multichannel video programming distributor operated by the franchising authority for that franchise area offers video programming to at least 50 percent of the households in that franchise area; or
>
> (D) a local exchange carrier or its affiliate (or any multichannel video programming distributor using the facilities of such carrier or its affiliate) offers video programming services directly to subscribers by any means (other than direct-to-home satellite services) in the franchise area of an unaffiliated cable

> operator which is providing cable service in that franchise area, but only if the video programming services so offered in that area are comparable to the video programming services provided by the unaffiliated cable operator in that area.

While the FCC's implementing regulations in 47 CFR 76.905(b) largely mirror the statutory definitions of "effective competition," the Commission's interpretations of these definitions have essentially gutted them.

As NATOA explained in its comments in the FCC's pending proceeding on rate regulation,[21] the FCC's decisions applying 47 U.S.C. § 543(l) and 47 CFR § 76.905(b) are flawed in several respects. For one thing, two or more cable operators often have overlapping franchises to serve an entire franchising area, but instead of overbuilding and competing with each other, they merely divide the market into non-competitive zones. Even though no subscriber has an actual choice between competing cable operators, the FCC has typically found that "effective competition" exists in these situations because the cable operators *might* compete with each other some day.[22]

Similarly flawed is the FCC's growing practice of determining "effective competition" solely on the basis of competition from Direct Broadcast Satellite (DBS) providers. Not only are such determinations fraught with evidentiary problems, but even assuming that competition from DBS providers can be established in a particular case, there is no evidence that competition from DBS providers exerts any downward pressure on cable rates.[23] To the contrary, as NATOA's comments point out, "the notion that DBS 'competition' alone suffices to keep rates reasonable flies in the face of the Commission's own finding that 'the presence of effective competition due to DBS overbuild status has no significant effect on cable rates.' The fact is that DBS 'competition' is not keeping rates down, no matter how much the cable industry may fear it. Thus, to depend on DBS is to abandon the Commission's responsibility under the law to protect subscribers from unreasonable rates."[24]

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21 *Implementation of Sections of The Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation,* MB Docket No. 02-144, Comments of The National Association of Telecommunications Officers and Advisors, the National League of Cities, and the Miami Valley Cable Council, pp. 26-36 (submitted November 4, 2002) ("NATOA Comments").

22 NATOA Comments, at 27. Notably, in its order approving the AT&T-Comcast merger, the FCC refused to apply a similar rationale in determining that Comcast and AT&T were not potential competitors in areas where they had contiguous systems. *AT&T/Comcast Merger Approval Order* ¶¶ 92-95.

23 Between June 30, 2001 and June 30, 2002, the Commission granted eight petitions for effective competition, representing 75 communities, based on competitive entry from LECs or their affiliates and DBS providers. *Ninth Annual Video Competition Report* ¶ 115.

24 NATOA Comments, at 27 (quoting the FCC in *Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992,* Report on Cable Industry

In its early cases involving the DBS test, the FCC appears to have been focusing on the prospect of rate *increases* by the incumbent. Now, however, the DBS test – and the FCC's precedents on it – have come into play in cases in which the incumbent's main purpose is to offer targeted discounts to thwart competition. A good example is the FCC's recent decision involving Arcadia, CA.[25] In that case, overbuilder Altrio Communications alleged

> [I]n November 2001, immediately before Altrio began its service launch and advertising campaign, Adelphia's rates were $33.33 for analog expanded basic service, and an additional $10.00 for digital expanded basic service and $39.99 for cable modem service. In addition, Adelphia offered expanded basic service at $19.95 per month, as well as cable modem service for $19.95 for the first three months of service, as a special promotion to new customers. Altrio indicates that after the launch of its service in December 2001, Adelphia offered an "extraordinary deal" to its existing customers for one year in which Adelphia increased its analog channels by twelve (57-69 channels), its digital channels by 81 (8-89 channels), dropped its rates to $19.95 for analog expanded basic service, charged only an additional $5.88 for digital expanded basic, and offered cable modem service for $19.95. Altrio also asserts that Adelphia customer service representatives engaged in "minute-by-minute" changes in its offers and short-term price cuts to retain existing customers contemplating a switch to Altrio, and to attract new customers.

Altrio Communications at ¶ 3. On their faces, these discriminatory rates plainly violated Section 623(d). Shortly after Altrio filed its complaint, however, Adelphia petitioned the FCC to find that it was subject to effective competition in Arcadia as of October 1, 2001, because two DBS providers, EchoStar and DirectTV, offered service in portions of the city. *Id.* at ¶ 5. The FCC agreed and dismissed Altrio's complaint. *Id.* at 6.

The FCC's interpretation of the fourth statutory criterion is also seriously defective.[26] When Congress fashioned the so-called "LEC test" in 1996, it intended the test to apply to the

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Prices, 17 FCC Rcd. 6301, ¶ 45 (2002)). *See also* the findings of the GAO, quoted above in footnote 5.

25 *Altrio Communications Inc. v. Adelphia Communications Corp.*, 17 FCC Rcd. 22,955, 2002 WL 31526760.

26 Among incumbent "effective competition" petitions relying on the LEC test are: *In the Matter of Armstrong Communications, Inc.,* Petition for Special Relief, Opinion and Order, 16 F.C.C. Rcd 1039, 2001 WL 43378 (released January 19, 2001); *In the Matter of Charter Cable Partners, LLC,* Petition for Determination of Effective Competition, Opinion and Order, DA 02-2842 (released October 25, 2002); *In the Matter of Time Warner Cable Partners,* Petition for Effective Competition, CSR-5701-E (filed May 4, 2001); *In the Matter of AT&T CSC, Inc.,* Petition for Effective Competition, CSR-6015-E, DA 02-3376 (released December 9, 2002); *In the Matter of Paragon Communications, Inc. d/b/a Time Warner Cable,* Petition for Determination of Effective Competition, CSR-5901-E, DA 02-3599 (released December 27, 2002); *In the Matter of Kansas City*

Bells and other major *incumbent* local exchange carriers, which Congress expected to become major and ubiquitous players in the cable industry.[27] The FCC, however, has applied the LEC test indiscriminately to *competitive* local exchange carriers,[28] even to those with as little as 15% current market share and little, if any, possibility of building out the rest of their systems for up to 5½ years.[29] To make matters worse, in the absence of a homes-passed or actual subscribership standard under the LEC test, as there is under the other tests in Section 623(l), the FCC has found that "effective competition" can be found to exist as long as the LEC is *planning* to provide cable TV service in an area overlapping the incumbent's territory.[30] In short, under the FCC's interpretation of the LEC test, "effective competition" can be found even where the competitor has a minimal number of subscribers and where the vast majority of customers in a given area have no competitive alternative at all.

So predictable have FCC rulings of "effective competition" become under the LEC Test, that some MSO's have not even bothered to file applications for such rulings before introducing discriminatory rate discounts. Like Adelphia in Arcadia, CA, Time Warner filed applications for effective competition determinations for Austin, San Marcos, and San Antonio, TX, only after private-sector overbuilder Grande Communications file a complaint alleging rate discrimination.[31] At the time of this writing, Time Warner's effective competition petition is still pending at the FCC.[32]

Cable Partners Petition for Determination of Effective Competition in Overland Park, Kansas (KS0064) Dkt. No. CSR-5993-E (Everest) (rel. February 3, 2003)

27 *See, e.g., Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996*, 14 FCC Rcd at 5302 (1999). (Congress expected LECs to be "robust competitors of cable operators because of their financial and technical ability and ... ubiquitous presence in the market.").

28 *See, e.g., Kansas City Cable Partners*, 16 FCC Rcd 18751 (CSB 2001).

29 *Time Warner Entertainment Co. L.P. d/b/a Time Warner Cable*, 11 FCC Rcd 1872 (CSB 1997); *In the Matter of Texas Cable Partners, L.P., Petition for Determination of Effective Competition in Corpus Christi, Texas* (TX0205), Dkt. No. CSR 5676-E, (rel. March 7, 2002).

30 *Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996, Report and Order*, 14 FCC Rcd 5296, 5311-13 ¶¶ 28-30 (1999).

31 Time Warner, Dkt. No. CSR-5701-E (filed May 4, 2001). If the FCC finds that effective competition exists in Austin, it will render the LEC Test a virtual nullity. As the City of Austin has pointed out in its comments, "out of an estimated 265,000 households in Austin, only 13,000 households – less than 5% -- even have access to Grande's services."

32 Ironically, in the telephone area, Time Warner Telecom has vigorously complained about the "winback" practices of Southwestern Bell. For example, Time Warner and other competitive local exchange carriers joined in advising the Public Utility Commission of Texas that "[n]iche pricing behavior distorts the marketplace to allow ILECs to

In summary, the FCC's interpretations of 47 U.S.C. § 543(l) and 47 CFR § 76.905(b) allow for "effective competition" rulings where meaningful competition does not exist. Far from identifying the markets in which competition has taken hold, the FCC's interpretations have perversely been transformed into vehicles that serve to defeat Congress's pro-competitive goals.

C. Denial of Video Programming and Other Critical Content

1. Video programming

In the Cable Act of 1992, Congress banned unfair and anticompetitive restrictions on access to cable programming, including certain exclusive contracts, and required satellite-based distributors in which MSOs had attributable interests to make cable programming available to competitors of the MSOs on a non-discriminatory basis.[33] As the FCC has recently observed, Congress included these programming access provisions in 1992 Act because it considered access to programming to be "critical to competitive survival."[34] "Congress believed it unlikely that new market entrants could compete effectively unless they could gain access to vertically integrated, satellite delivered programming," and "incumbent providers had both the incentive and the ability to deny [access] to new competitors."[35]

Before discussing the strengths and weaknesses of the current programming access laws and regulations, it is useful to examine the state of vertical integration in the cable industry. "Vertical integration" in this context means that one or more MSOs hold a significant ownership interest in a video programming distributor.[36] Of the 308 satellite-delivered national

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perpetuate their market power into the future and [leads] to higher prices and less choice to customers as a whole." Joint Comments, *Rulemaking to Address Winback/Retention Offers By Chapter 58 Electing Companies, Project No. 25784*, at 6 (filed December 13, 2002).

33 Section 628 of the Communications Act, 47 U.S.C. § 548. The FCC's rules implementing Section 628 are in 47 C.F.R. §§ 76.1000 – 76.1004.

34 *In The Matter of Implementation Of The Cable Television Consumer Protection and Competition Act of 1992, Development of Competition and Diversity in Video Programming Distribution, Section 628(c)(5) of the Communications Act Sunset of Exclusive Contract Prohibition, Report and Order*, at ¶ 7, 17 FCC Rcd. 12,124, 2002 WL 1396090 (rel. June 28, 2002)("*Exclusive Contracts Report*"). As the FCC noted, at *id.* ¶ 7 n.7, "[t]he record before Congress, leading up to and including the 1992 Cable Act, was replete with references to the importance of access to vertically integrated programming to competitive MVPDs [multichannel video programming distributors]."

35 *Exclusive Contracts Report* at ¶ 7.

36 The FCC does not specify the criteria that it used to derive its vertical integration figures, which we summarize in this paragraph. The FCC's regulation defining attributable interests, Section 47 C.F.R. ¶ 76.501 n.2(a), states that an attributable interest will generally be found where there are "partnership and direct ownership interests and any

programming networks existing in 2002, 92 (approximately 30 percent) were vertically integrated with at least one cable MSO. *Ninth Annual Video Competition Report* at ¶ 134. Four of the top six cable MSOs held ownership interests in programming networks, and at least one of these MSOs had an interest in 79 of these 92 networks. *Id.* at ¶ 135. In terms of subscribership, eight of the top 20 video programming networks were vertically integrated with a cable MSO in 1992. *Id.* at ¶ 136. Furthermore, of the top 50 programming networks, only four were not affiliated with a cable company – C-SPAN, C-SPAN2, WGN, and the Weather Channel. Of these four, MSOs provided 95% of the funding for C-SPAN and C-SPAN2. *Ninth Annual Video Competition Report* at ¶ 136 n. 451. Thus, vertical integration and other potential sources of MSO influence over video programming distributors is a major fact of life in the cable industry.

Against this backdrop of extensive vertical integration and control, the statutory requirements and FCC rules on programming access fall into three categories. First, Section 628(b) of the Communications Act, 47 U.S.C. § 528(b), sets forth a general prohibition on unfair practices by vertically integrated cable operators and satellite-delivered programming vendors.[37] Second, Section 628(c) of the Communications Act, 47 U.S.C. § 528(c), prohibits vertically integrated cable operators and programming vendors from engaging in certain specific unfair practices.[38] These practices include exertion of undue or improper influence on the programming vendor's prices, terms and conditions, and discrimination in establishing prices, terms or conditions (subject to several exceptions).

Third, Sections 628(c)(2)(C) and (D) of the Communications Act, 47 U.S.C. §§ 528(c)(2)(C) and (D), prohibit vertically integrated cable operators and programming vendors

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voting stock interest amounting to 5% or more of the outstanding voting stock of a corporation." For the purpose of determining vertical integration, however, the FCC apparently used a higher percentage than 5%. Thus, in Table C-1 in the *Ninth Annual Video Competition Report* in which the FCC presents the data supporting its vertical integration figures, MSOs owned interests of 20 percent or more in all but two of the video programming distributors listed, and in most instances, MSOs owned 100 percent of these video programming distributors.

37 The FCC's corresponding regulation, 47 C.F.R. § 76.1001, reads as follows: "UNFAIR PRACTICES GENERALLY. No cable operator, satellite cable programming vendor in which a cable operator has an attributable interest, or satellite broadcast programming vendor shall engage in unfair methods of competition or unfair or deceptive acts or practices, the purpose or effect of which is to hinder significantly or prevent any multichannel video programming distributor from providing satellite cable programming or satellite broadcast programming to subscribers or consumers."

38 The FCC's corresponding regulation, 47 C.FR. 76.1002(a), states as follows: "SPECIFIC UNFAIR PRACTICES PROHIBITED. No cable operator that has an attributable interest in a satellite cable programming vendor or in a satellite broadcast programming vendor shall unduly or improperly influence the decision of such vendor to sell, or unduly or improperly influence such vendor's prices, terms and conditions for the sale of, satellite cable programming or satellite broadcast programming to any unaffiliated [MVPD]."

from entering into, or renewing, exclusive contracts under most circumstances.[39] This prohibition was to expire on October 5, 2002, unless the FCC affirmatively determined that extending it by up to five years was necessary and in the public interest. In June 2002, following an extensive notice-and-comment proceeding, the FCC did so, finding that:

> It is evident that competition in the MVPD market has increased in some respects since 1992. We are not persuaded by the arguments presented by cable MSOs, however, that market conditions have changed so fundamentally, and competition in the distribution of video programming is now so robust, that vertically integrated programmers no longer have the incentive to favor affiliated cable operators such that, in the absence of the prohibition, competition and diversity in the distribution of video programming would not be preserved and protected.

Exclusive Contract Report at ¶ 65.

Significantly, the FCC declined to use this opportunity to close loopholes in its exclusive contracts rules, particularly the failure of the rules to bar exclusive contracts involving video programming delivered *terrestrially* by fiber optic cable. The FCC was well aware of the significance of this gap: "We recognize that the terrestrial distribution of programming, including in particular regional sports programming, could have an impact on the ability of alternative MVPDs to compete in the video marketplace."[40] The FCC also recognized that vertically integrated entities "may have an incentive to shift regional sports networks from satellite to terrestrial distribution and thereby avoid the ambit of program access rules."[41] Furthermore, the FCC was aware that increased "clustering" in the cable industry could exacerbate the anticompetitive effects of terrestrially-delivered video programming.[42]

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39 The FCC's corresponding regulation, 47 C.F.R. § 76.1002(c), provides: "EXCLUSIVE CONTRACTS AND PRACTICES – (1) Unserved areas. No cable operator shall [enter into an exclusive contract with a satellite programming vendor] that prevents a [MVPD] from obtaining such programming from any satellite cable programming vendor in which a cable operator has an attributable interest, or any satellite broadcast programming vendor in which a cable operator has an attributable interest for distribution in areas not served by a cable operator as of October 5, 1992. (2) Served areas. No cable operator shall enter into any exclusive contracts, or engage in any practice, activity or arrangement tantamount to an exclusive contract, for satellite cable programming or satellite broadcast programming with a satellite cable programming vendor in which a cable operator has an attributable interest or a satellite broadcast programming vendor in which a cable operator has an attributable interest, with respect to areas served by a cable operator, unless the Commission determines that such contract, practice, activity, or arrangement is in the public interest. . . . (6) Sunset provision. The prohibition of exclusive contracts . . . shall cease to be effective on October 5, 2002. . . ."

40 *Eighth Annual Video Competition Report* ¶*14*.

41 *Eighth Annual Video Competition Report* ¶173 (citing RCN Comments).

42 *Exclusive Contract Report* at ¶ 47.

> [I]t is likely that cable systems in a large cluster will be linked through a fiber optic network which would enable operators to offer telecommunications services as well as a cost-efficient means of delivering programming to its clustered systems. However, if MSOs have an ownership interest in programming, fiber optic networks may give them an added incentive to 'migrate' programming from satellite delivery to terrestrial (fiber optic) delivery because only satellite-delivered programming is subject to the program access rules. Therefore . . . a vertically integrated incumbent may be able to prevent competitors from gaining access to certain programming because it is terrestrially delivered.[43]

Nevertheless, the FCC declined to address terrestrially-delivered programming in its *Exclusive Contracts Report*, concluding that it lacks statutory authority to extend its exclusive contracts rules beyond satellite-delivered programming:

> The Commission has noted that terrestrial distribution of programming could have a substantial impact on the ability of competitive MVPDs to compete in the MVPD market. Nonetheless, the Commission has concluded that the language of Section 628(c) expressly applies to "satellite cable programming and satellite broadcast programming," and that terrestrially delivered programming is "outside of the direct coverage of Section 628(c)." We have been presented with no basis to alter that conclusion in this proceeding. To the contrary, the legislative history to Section 628 reinforces our conclusion. The Senate version of the legislation that became Section 628 would have applied the program access provisions to all "national and regional cable programmers who are affiliated with cable operators." The House version, by contrast, expressly limited the provisions to "satellite cable programming vendor[s] affiliated with a cable operator." The Conference agreement adopted the House version with amendments. Given this express decision by Congress to limit the scope of the program access provisions to satellite delivered programming, we continue to believe that the statute is specific in that it applies only to satellite delivered cable and broadcast programming.

Exclusive Contracts Report at ¶ 73 (footnotes omitted).[44]

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[43] *Eighth Annual Video Competition Report* at ¶ 142 (paraphrasing comments received in proceeding).

[44] The terrestrial-delivery loophole has also been upheld by the courts. In 2002, the United States Court of Appeals for the District of Columbia Circuit affirmed an FCC decision that Comcast's refusal to grant DBS provider EchoStar the right to carry SportsNet, a terrestrially-delivered regional sports programming network owned and controlled by Comcast, did not violate the FCC's program access rules. *Echostar Comm Corp v. FCC,* 292 F.3d 749 (D.C. Cir. 2002). In denying EchoStar's complaint, the FCC had concluded that the program access rules did not apply because SportsNet was delivered terrestrially rather than by satellite. The D.C. Circuit found that Comcast's reliance on the inapplicability of the program access rules to terrestrially-delivered programming was not

Later in 2002, the FCC returned to these and other programming-access concerns during its review of the AT&T/Comcast merger. Once again, it decided not to act:

> With respect to nationally distributed programming, the record contains little evidence that the program access rules will be insufficient to ensure that competing MVPDs have access to important programming that is affiliated with a cable operator. To the extent that affiliated national programming is delivered via satellite, it is covered by our program access rules. Nothing in the record suggests that the merger would affect the cost of transmitting affiliated national programming over terrestrial infrastructure and thereby make it more cost-effective to deliver such programming in that manner..... [W]e cannot conclude that the merger will harm the public interest with respect to exclusive distribution of affiliated, satellite-delivered national programming.[45]

With regard to clustering – which would be a particularly significant issue in the context of the AT&T Comcast merger – the FCC concluded, "To the extent that clustering raises concerns about a cable operator's ability to secure exclusive distribution rights for certain programming, such concerns would apply industry-wide .... The appropriate forum for consideration of this issue, therefore, is a rulemaking of general applicability." In fact, the FCC maintained, it had already initiated such a rulemaking proceeding "to establish limits on cable operators' horizontal reach pursuant to § 613 of the Communications Act, which directs the Commission to establish such limits to prevent cable operators, because of their subscriber reach, from unfairly impeding the flow of programming to consumers."[46]

The application of the program access rules to terrestrially-delivered programming is likely to be increasingly necessary to accomplish the objectives of the program access statute. As the program access statute itself only concerns "satellite-delivered programming," however, it appears that Congressional action may be required to effect such a change.

b. Other forms of content

As consumers come to expect cable operators to provide new enhanced products and services, the risk grows that MSOs will be able to gain advantages over nascent competitors by blocking their access to such new enhanced products and services. This has already begun to occur in the context of interactive television services (ITV). One such service is video-on-demand (VOD).

At the time of the AT&T/Comcast merger, Comcast possessed an 11 percent ownership interest, and AT&T a 44 percent interest, in iNDEMAND, a VOD service provider. According

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an impermissible evasion of the program access rules, and that there were valid business reasons for choosing terrestrial delivery.

45 *Eighth Annual Video Competition Report* at ¶12.

46 *AT&T/Comcast Merger Approval Order*, ¶ 15 (footnotes omitted).

to the Consumer Federation of America, Comcast's use of exclusive contracts and discriminatory conduct has allowed Comcast to make "substantial inroads" with content suppliers. *AT&T/Comcast Approval Order* at ¶ 161. Similarly, RCN claimed that Comcast's financial interest in Worldgate's TV Gateway product had enabled Comcast to block RCN's access to that product. *Id.* Elsewhere, WideOpenWest had reported to the FCC that it could not obtain access to iNDEMAND because of an exclusive contract between it and an MSO,[47] and Everest Connections had reported that, for the same reason, it could not obtain access to iNDEMAND and two other VOD services, Diva and Concurrent.[48]

The FCC declined to address the issue of competitive access to VOD in the context of the AT&T/Comcast merger, stating that the merger "will not enhance or create incentive to impede technological developments in the emerging ITV market" and that "the merged entity would not serve a large enough proportion of MVPD subscribers to close out competitors through exclusive contracts." *Id.* at ¶ 165. Previously, however, in a Notice of Inquiry (NOI) focusing specifically on the implications of vertical integration in ITV services, the FCC had solicited comments on "whether cable operators should be prohibited from discriminating among ITV service providers." *In the Matter of Nondiscrimination in the Distribution of Interactive Television Services Over Cable,* CS Dkt. No. 01-7, Notice of Inquiry, FCC 01-15 (rel. January 18, 2001) at ¶ 3. That proceeding is still open.

VOD is just beginning to take hold. By 2005, VOD revenues are projected to range between $278 million and $3 billion. *Ninth Video Competition Order* at ¶ 39. If anticompetitive practices in the ITV area are to be prevented, the time to do so is now.

D. Blocking Access to Multiple Dwelling Units

An overbuilder can enter a community only if it has a reasonable prospect of meeting substantial market penetration targets. That would be difficult, if not impossible, to do if the incumbent could shut the overbuilder out of a substantial portion of the market. Tying up multiple dwelling units (MDUs) in exclusive long-term contracts is yet another way that MSOs have thwarted competition from overbuilders.

For example, in many communities in North Carolina, including Charlotte and Raleigh, MDUs comprise over 30 percent of the cable subscriber market.[49] Upon learning that Carolina Broadband intended to overbuild the area, the incumbent cable operator, Time Warner, mounted an aggressive campaign to secure long-term, exclusive contracts with the owners of the MDUs that Carolina Broadband sought to serve. Among other things, Time Warner heavy-handedly threatened to disconnect cable service if the owners of the MDUs did not agree to sign exclusive

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47 Reply Comments of WideOpenWest in CS Dkt. No. 00-129 at 8-9.

48 Comments of Everest Connections in CS Dkt. No. 00-129 at 8.

49 According to one estimate, 20 – 23 percent of a cable operator's income comes from MDU subscribers. *See Larry* Kessler, *Good Night, Gorilla; Good Morning, Guerilla,* Private and Wireless Broadband, Mar. 2001 at 12.

agreements of five or more years.[50] According to the FCC, Time Warner obtained long-term commitments affecting approximately 80 percent of the MDU units in Charlotte, with "many of these agreements taking place after Carolina Broadband announced its intent to serve the area."[51] Time Warner's tactics proved to be very effective: without access to nearly one-third of its potential subscribers, Carolina Broadband's overbuild efforts ground to a halt.

The FCC raised concerns about exclusive cable contracts in MDUs in a rulemaking initiated in 1997.[52] After allowing the rulemaking to languish for nearly six years, the FCC concluded on January 29, 2003, that the record before it did not justify a ban or a time limit on such contracts:

> In sum, we find that the record does not support a prohibition on exclusive contracts for video services in MDUs, nor a time limit, in the nature of a cap, for such contracts. The parties have identified both pro-competitive and anti-competitive aspects of exclusive contracts. We cannot state, based on the record, that exclusive contracts are predominantly anti-competitive. With respect to capping such contracts, there appears to be little agreement over the length of term. Again, based on the record, we cannot discern the "correct" length. We note that competition in the MDU market is improving, even with the existence of exclusive contracts. Accordingly, we decline to intervene. Because we are not banning or capping exclusive contracts, we also decline to address arguments pertaining to the Commission's authority to do so.[53]

Having so recently decided this issue, it is unlikely that the FCC would want to revisit it anytime soon – at least in isolation from other anticompetitive activities. Carolina Broadband's experience suggests, however, that the information that the FCC obtained when it launched its inquiry on MDUs years ago may not fully reflect current realities.

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50 Time Warner's activities in North Carolina were strikingly similar to Southwestern Bell's successful "lock up" activities to tie up the market for pay phones in Oklahoma, which resulted in an award of treble damages against Southwestern Bell totaling $20 million. *Telecor Communications Inc. v. Southwestern Bell Telephone Co.*, 305 F.3d 1124 (10th Cir. 2002).

51 *Eighth Annual Video Competition Report* ¶ 129; *see also Ninth Annual Video Competition Report* ¶¶ 118-121.

52 *In the Matter of Telecommunications Services, Inside Wiring, Customer Premises Equipment; In the Matter of Implementation of the Cable Television Consumer Protection and Competition Act of 1992: Cable Home Wiring;* CS Docket No. 95-184, MM Docket No. 92-260, *Report and Order and Second Further Notice of Proposed Rulemaking*, 13 FCC Rcd 3659 (1997).

53 *In the Matter of Telecommunications Services Inside Wiring ...*, CS Docket No. 95-184, MM Docket No. 92-260, *First Order on Reconsideration and Second Report and Order* at ¶ 71 (rel. January 29, 2003).

E. Other Anticompetitive Practices

MSO's have also engaged in a host of other anticompetitive practices. These include, but are by no means limited to, the following activities:

- Refusing to deal with suppliers and contractors that provide services to competitors[54]
- Hiring away key employees of competitors[55]
- Using litigation to prevent or delay competition[56]
- Refusing to carry advertising of overbuilders[57]
- Interfering with local franchise processes[58]

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54 For example, in its *AT&T/Comcast Approval Order*, the FCC noted that RCN had reported that "Comcast . . . [has] attempted to prevent contractors from doing business with RCN in Philadelphia by requiring them to sign non-compete clauses in their contracts and by threatening any contractors found working for RCN with reprisals." *Id.* at ¶ 36. Everest Connections reported that it could not purchase set top converters from Scientific-Atlanta or Pioneer because of restrictions demanded by incumbents. Comments of Everest Connections in CS Dkt. 00-129 at 8. AT&T allegedly fired a local installations vendor in Provo, UT, for performing services for the City's cable system. *Multichannel News*, "Overbuild Deal Costs an AT&T Vendor," (February 5, 2001) at 20.

55 On October 9, 2001, at a conference in Seattle, WA, sponsored by the American Public Power Association, a representative of Click! Network of Tacoma, WA, reported that AT&T Broadband had repeatedly engaged in this and various other "dirty tricks."

56 In enacting the Cable Act of 1992, Congress observed that "incumbent cable systems often wage legal battles to prevent cities from awarding second franchises." S. Rep. No. 102-92, 102nd Cong., 1st Sess. 1991, 1991 WL 125145 at *13 (Leg. Hist.). More recently, in *Knology, Inc. v. Insight Communications Co., LP, et al.*, Civ. No. 3:00CV-723-R (W.D. Ky.), Knology alleges that the incumbent cable operator, Insight, filed a "sham" level-playing-field suit against the City of Louisville to thwart or significantly delay Knology's entry into the market. The City subsequently won summary judgment dismissing all claims asserted by Insight. *Insight Communications Co. LP, et al. v. City of Louisville, KY*, Opinion and Order, Dkt. No. 00-CI-007100 (March 21, 2002) (appeal pending), http://www.baller.com/pdfs/loukydecision.PDF.

57 In Gainesville, FL, Cox Cable refuses to carry advertising of its competitor, Gainesville Regional Utilities.

58 Section 621(a)(1) of the Communications Act, § 541(a)(1), expressly prohibits exclusive cable franchises, and the courts have frequently held that incumbent cable operators have

- Flooding local media with misinformation about public communications initiatives[59]

- Lobbying for anticompetitive state laws[60]

Combined with the other anticompetitive practices discussed above, these tactics seriously undermine the pro-competitive goals that Congress has expressed for the cable industry for the last two decades.

Conclusion

As shown above, anticompetitive conduct by MSOs takes many forms and shapes. Addressing such misconduct on a case-by-case basis before the FCC, the DOJ, the FTC, state agencies or the courts would be prohibitively burdensome, time-consuming and expensive for NATOA and its allies. This would also be true of an issue-by-issue approach before the FCC or Congress. Furthermore, partial successes that left major areas of anticompetitive conduct intact would ultimately do little to create a truly competitive environment.

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no standing to interfere with a local government's consideration of a competitive franchise. See, e.g., *United Cable Television Services Corp. v. Dep't of Public Utility Control*, 235 Conn. 334, 663 A.2d 1011, 1019 (1995); *New England Cable Television Ass'n, Inc. v. Department of Public Utility Control*, 27 Conn. 95, 717 A.2d 1276, 1283 (1998); *In re Dakota Telecommunications Group*, 590 N.W.2d 644, 648 (Minn. App. 1999). In its *AT&T/Comcast Approval Order* ¶ 35, the FCC noted that RCN had complained that "Comcast's interference with its local franchise negotiations in Prince George's County, Maryland and in Philadelphia, Pennsylvania, kept RCN from securing a cable franchise."

59 For example, officials of the Tri-Cities of St. Charles, Batavia and Geneva, Illinois, contend that Comcast and Southwestern Bell have conducted severely biased "surveys" of public opinion and bombarded the area with disinformation to dissuade voters from approving a $62 million public communications network. Comcast's and Southwestern Bell's misstatements and responses to them are available online at http://www.tricitybroadband.com; http://www.surfcity.net/cabletv/kramerfirm/joe/Page28.htm

60 Cable companies and their national and state trade associations have been at the forefront of efforts to persuade state legislatures to ban or significantly impair the ability of public entities to provide or facilitate the provision of competitive services in their communities. For example, after obtaining restrictive legislation in Virginia, the Virginia Cable Telecommunications Association crowed: "Another competitive threat was muted this session when the legislature included cable-backed 'level playing field' language into a bill that allowed municipal utility companies to enter the telecom business." http://www.vcta.com/industry/reg_reports/march2002.doc.

In short, anticompetitive behavior by MSOs is a multi-headed monster. In the Cable Act of 1992, Congress lopped off the anticompetitive heads that were known at the time by barring targeted rate discrimination, promoting access to home wiring and satellite-delivered video programming, and prohibiting recognized forms of unfair competition. Like Hydra of Greek mythology, however, the monster has grown new heads to replace the ones that Congress severed in 1992. Legend has it that Hercules ultimately defeated Hydra by cauterizing its wounds with a hot iron as he chopped away.

[The remainder of this report consisting of recommendations, legal advice and strategy has been deleted by NATOA.]

SPECIFIC EXAMPLES OF ANTICOMPETITIVE CONDUCT BY INCUMBENT NATIONAL CABLE OPERATORS

Adelphia Communications Corporation

Arcadia, California

Competitive Service Provider: Altrio Communications

- In November 2001, immediately before Altrio began its service launch, Adelphia's rates were $33.33 for analog expanded basic service, an additional $10 for digital expanded basic service, and $39.99 for cable modem service. After Altrio's launch, Adelphia increased its analog channels by twelve, its digital channels by 81, dropped its rates to $19.95 for analog expanded basic service, charged only an additional $5.88 for digital expanded basic, and offered cable modem service for $19.95.
- In a complaint to the FCC, Altrio alleged that Adelphia sought to eliminate Altrio as a competitor, and violated the geographic rate uniformity requirement.[61] *Complaint of Altrio Communications Inc., Against Adelphia Communications Corporation for Discriminatory and Predatory Pricing of Cable Service,* CSR-5862-R (filed March 1, 2002).
- Adelphia responded to the complaint, arguing that it is subject to local exchange carrier (LEC) effective competition, and therefore exempt from the uniform pricing requirement, because Altrio provides local exchange telephone service in Arcadia. Adelphia filed an unopposed petition for effective competition, and the FCC found (based on the competing provider test) that Adelphia was subject to effective competition as of October 1, 2001.
- Altrio's petition was dismissed by the FCC because Adelphia's effective competition status made the uniform rate rules inapplicable.[62]

Charter Communications Corporation

Montgomery, Alabama

Competitive Service Provider: Knology

- Charter acquired the incumbent cable system in 2001 from AT&T Broadband, immediately lowered the price of its digital tier, and offered Knology customers a $300 cash bounty to switch to Charter.

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61 47 C.F.R. 76.984

62 *Altrio Communications, Inc. v. Adelphia Communications Corporation*, Memorandum Opinion and Order, DA 02-3172 (released November 15, 2002).

- During the summer of 2001, Charter began to offer a "digital complete" service for less than $23 per month, including all analog expanded basic services, 50 channels available only on the digital tier, and 50 channels of digital music.
- Charter forgives past unpaid cable bills by customers who switch from Knology.
- In March, 2002, Charter offered an expanded basic service at a rate of $13.42 per month for 12 months, with high speed Internet access for an additional $19.95, for 3 months.
- Knology contends that Charter is taking a significant loss on each new customer, but will be able to recoup its losses once it has driven its competitors out of the market. Knology filed a complaint with the FCC, but the FCC stated: "it is not clear that we have specific statutory authority to address these kinds of problems directly."[63]

Realtown, Alabama

Competitive Service Provider: Com-Link

- During the summer of 2001, Charter paid a $300 cash bounty to each Com-Link customer who switches to Charter.

Scottsboro, Alabama

Competitive Service Provider: Scottsboro Electric Power Board (Scottsboro)

The Scottsboro Electric Power Board began construction of a municipally owned cable television system in Scottsboro because of widespread customer dissatisfaction with the incumbent, Falcon Cablevision. In late 1999, Charter acquired Falcon's operation in Scottsboro, and began a course of predatory conduct designed to terminate Scottsboro's efforts to compete and survive in the market.

- Charter's rate for Basic and Expanded Basic cable service is $0, for anyone who has received cable service from Scottsboro. Nearby, Charter charges customers up to $45 per month for Basic and Expanded Basic.
- In April 2000, Charter offered digital service with premium channels to Scottsboro customers for $19.95 per month for 12 months. Thereafter, Charter allowed a number of customers to renew at this rate. These rates are available only to Scottsboro customers, and not available to all potential subscribers in Scottsboro.
- Charter offered an "amnesty program" to forgive prior unpaid bills.
- Charter offered a $200 cash bounty to each Scottsboro customer who switches to Charter, with an additional $200 if subscribers take its Internet service.
- Charter offers to cut rates by $20 per month for six months "only to people who are not current customers of Charter Communications." In the coupons it distributed, Charter predicted that "[r]esponse to this offer will be enormous."
- Charter reportedly is losing between $6 and $16 per month for every customer, on programming costs alone.

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63 *Eighth Annual Video Competition Report,* at ¶209. Scottsboro's comments are available online at http://www.baller.com/library-comments.html.

- Scottsboro filed comments about Charter's anticompetitive conduct in the FCC's annual docket reviewing the status of competition in the cable market, but FCC took no action because "it is not clear that we have specific statutory authority to address these kinds of problems directly."64

Troy, Alabama

Competitive Service Provider: Troy Cable

- Charter offers analog expanded service for $15.99 per month, and a digital package for $24.95.
- Charter offers a $200 cash bounty to each Troy customer who switches to Charter.

Newnan, Georgia

Competitive Service Provider: Newnan Utilities

- Charter offers analog expanded basic services for $19.95 per month, and a digital package for $24.95.
- Charter offers a $300 cash bounty to each Newman Utilities customer who switches to Charter.
- Starting April, 2002, Charter began telephone solicitations targeted at NU customers offering cable services at half price for one year.
- Charter offers to cut rates by $20 per month for six months "only to people who are not current customers of Charter Communications." In the coupons it distributed, Charter predicted that "[r]esponse to this offer will be enormous."

West Point, Georgia

Competitive Service Provider: Knology

- Charter offers analog expanded basic service for $19.95 per month, and a digital package for $24.95. Its rate card for analog expanded basic service is $35.95.
- Charter pays a $200 cash bounty to each Knology customer who switches to Charter. The offer requires a commitment to remain with Charter for 12 months, and assesses a penalty of $25 per month if the commitment is not honored.

Coldwater, Michigan

Competitive Service Provider: Coldwater Board of Public Utilities

- Charter offers analog expanded basic service for $19.95 per month.

64 *Id.*

- Charter pays a $100 cash bounty to each CBPU customer who switches to Charter.

Marshall, Minnesota

Competitive Service Provider: McLeod USA

- Charter offers "Digital MVP" service for $19.95, including expanded basic service, digital service, and six premium movie channels.
- Offer requires that the customer remain with Charter through the end of 2001, and charges a $10 per month penalty if service is cancelled.

St. Cloud, Minnesota

Competitive Service Provider: Seren Innovations/Astound Broadband

- Charter offers expanded basic and digital service with 34 premium channels for $39.95 per month, and for as low as $16.67 for expanded basic service over six months. The rate card for this level of service is $59.95.
- Charter offers the above service plus high speed Internet access for $49.95. The rate card for this service is $89.95.
- Charter pays a $100 cash bounty to each Seren/Astound customer who switches to Charter.

Winona, Minnesota

Competitive Service Provider: Hiawatha Broadband

- Charter offers "Digital MVP" service for $29.95. Service includes expanded basic service, digital service, and six premium movie channels.
- $100, $150, and $200 credits are offered to Hiawatha Broadband customers who switch to Charter.

Ashland, Oregon

Competitive Service Provider: Ashland Fiber Network

- Charter offers free TV service to Resident Apartment Managers in exchange for leads when new tenants move in.
- Charter offers switch and win-back incentives, including a free turkey at Thanksgiving; free pay-per-view coupons, popcorn and soda; and a "$200 cash offer to switch back from AFN"
- AFN does not provide any free services; all customers pay one consistent rate with no special deals.
- Southern Oregon University sought bids for residence hall cable television services in the summer of 2001. Charter was providing cable services for the dorms at that time for approximately $67,000 annually. AFN submitted a bid for the services of approximately $40,000 – reflecting AFN's cost with essentially no markup. Charter bid $21,287.70 and

was awarded the contract, which was signed in September, 2001. Charter failed to break even on the deal.

Fayetteville, Tennessee

Competitive Service Provider: Fayetteville Electric System

- Charter offers expanded basic analog service for $19.95 per month, and "Digital Complete" service for $29.95 and $39.95.
- Charter offers $200 cash payments to FES customers who switch to Charter.
- Starting April 2002, Charter offers FES customers $200 credits "for disconnecting existing cable service from your current provider."
- Charter offers expanded basic analog service for $23.66 – guaranteed "through May 31, 2004" – to "active Non-Charter cable customers in Charter wired overbuilt areas." The offer requires customer signature and purports to assess a fine of $19.95 per month of service is cancelled during the term of the agreement.

Columbia, Tennessee

Competitive Service Provider: Columbia Power & Water Systems

- Columbia Power & Water Systems is several months away from launching their cable system, but Charter has begun offering apartment complex owners $150 per unit for exclusive agreements.

Parkersburg, West Virginia

Competitive Service Provider: Community Antenna Services

- Charter improperly offered discounted rates to potential customers of CAS who attempted to cancel Charter service.
- Discriminatorily offered a total of 8 aggressive, below-cost buy-back plans targeted at CAS customers, some by door-to-door salesmen. Only customers who have CAS service available and either leave Charter or threaten to leave Charter for CAS are offered the plans.
- Charter offers expanded basic analog service for $24.95 per month, and adds the digital tier for another $5.00.
- Charter offers a $200 cash payment to CAS customers who switch to Charter.
- CAS filed a Complaint before the Public Service Commission of West Virginia (Case No. 01-0646-CTV-C). The ALJ made findings against Charter, entered August 19, 2002, as follows:
    - Charter failed to rebut presumption that there is no "effective competition" (CFR § 76.907(b)) in any of the franchise areas at issue. PSC made determination there was none.
    - Charter ordered to "cease and desist engaging in rate discrimination"
    - Charter violated WV PSC rules regarding notice of rate changes, requiring cable operators to give the PSC a 60-day notice of any change in cable service rates.
- CAS is continuing to pursue civil litigation to recover damages.

Chibardun, Wisconsin

Competitive Service Provider: Chibardun Telephone Cooperative

- Charter offers expanded basic analog service for $19.95 and $24.95.
- Charter offers $200 and $300 cash payments to CTC customers who switch to Charter.

AT& T and Comcast Corporation

San Francisco, California

Competitive Service Provider: Seren Innovations

- Seren Innovations complained to the FCC alleging that AT&T colluded with partners to deny Seren access to the Bay TV programming service, in violation of the FCC's program access rules.

Augusta, Georgia

Competitive Service Provider: Knology

- Comcast offers expanded basic analog service for $18.95 per month. The standard rate is $33.25.
- Comcast offers a digital package with expanded basic, digital tier, 2 premium channels and high speed Internet access for $49.95 per month. The standard rate is $109.70.

Braintree, Massachusetts

Competitive Service Provider: Braintree Electric Light Department

- The Braintree Electric Light Department (BELD) complains that it has been unable to secure a distribution agreement with the New England Cable News channel, which is affiliated with AT&T, because the service has been moved to terrestrial delivery and falls outside of the FCC's program access rules.

Michigan & Illinois (multiple communities)[65]

Competitive Service Provider: WideOpenWest

- Comcast offers selective, unpublished, predatory discounts (50% off for 12 months), targeted to Comcast customers who express interest in switching to WideOpenWest.

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65 Comcast is making these offers to WideOpenWest customers in communities throughout southeastern Michigan, where Comcast operates a cluster of cable systems from one or more centralized locations.

- "In some cases, neighborhoods that are about to be overbuilt (by WideOpenWest) are telemarketed, and subscribers are asked to sign a multiple-month commitment in exchange for a deep discount." (Multichannel News, April 8, 2002).
- As of April, 2002, Comcast targeted telephone solicitations to WideOpenWest customers, offering expanded basic analog service for $18.00 per month for six months, with free installation, if WideOpenWest customers return to Comcast.
- Comcast offers expanded basic analog service for $21.95 per month. The standard rate is $33.95.
- Comcast offers a digital package with expanded basic and the digital tier for $34.95. The standard rate is $50.95.
- WideOpenWest filed objections to consent of Comcast AT&T Broadband merger, and sent a letter to 42 local franchising authorities in Michigan and Illinois urging them to condition consent to the merger in a way that would preserve the benefits of competition.
- "Comcast will argue that these selectively targeted discriminatory rates are merely aimed at "meeting the competition." It's far more evident the aim is ending any competition. Pricing plans are supposed to be available on a non-discriminatory basis. These Comcast offers are not advertised to all current and potential Comcast customers; rather, this discriminatory and anti-competitive pricing scheme is being administered secretively and selectively. It is communicated only to those individuals living in areas serviced by WideOpenWest who selected, or wish to switch to, WideOpenWest. This discriminatory marketing strategy has a clear strategic intent – to ultimately eliminate WideOpenWest's competitive presence, to the eventual and long-lasting harm to all residents." [Mark Haverkate, President & CEO, WideOpenWest, in a March 22, 2002 letter to 42 local franchise authorities in Michigan and Illinois urging that consent to the Comcast AT&T Broadband merger be conditioned in a way that would preserve the benefits of competition.]
- WideOpenWest reports that Comcast has frequently disconnected WideOpenWest subscribers, and provided substantial misinformation to customers wishing to switch.

Philadelphia & New York City

Competitive Service Provider: RCN

- Lack of access to regional sports programming has made it difficult for RCN to compete with Comcast's cable offerings. Specifically, RCN argues that Comcast has imposed unfair terms and conditions on access to its SportsNet regional and local sports programming, and has purposefully migrated to a terrestrial delivery system in avoidance of the FCC's program access rules.

South Dakota (Yankton and other communities)

Competitive Service Provider: McLeod USA

- Comcast offers all services to McLeod customers – analog, digital, high speed Internet access – free for three months, and then 50 percent off for three more months.

Various Communities

Competitive Service Provider: RCN

- Comcast uses targeted marketing campaigns, in which discounts are offered only to customers of Starpower, RCN's affiliate, or residents of areas in which Starpower competes or has begun to deploy services. Comcast offers bonuses to sales representatives who convert RCN subscribers to Comcast.
- Discounts are offered to other residents only if they know about and specifically request the offer.
- RCN alleges that Comcast has used the local franchise process to hinder competition in its local franchise areas.
- Starpower has encountered several buildings in which Comcast and its predecessors have received exclusive rights to serve the buildings and it tenants.
- RCN alleges that Comcast and its predecessors have attempted to prevent contractors from doing business with RCN by requiring them to sign non-compete clauses and by threatening with reprisals any contractors found working for RCN.

Time Warner Cable

Kansas City, Missouri

Competitive Service Provider: Everest Connections

- The incumbent, Kansas City Cable Partners (jointly owned by Time Warner and AT&T) offers steeply discounted pricing for persons in new Everest areas, not generally offered in places where Everest has not started marketing services.
- Time Warner offers expanded basic analog service for $21.45 per month, and offers a "digital deluxe" package with expanded basic, digital tier, and three premium channels for $39.95 per month.
- Time Warner offers a $200 cash payment to Everest customers who switch. Additional payments are made for customer testimonials in favor of Time Warner. At the same time, Time Warner raises rates for other subscribers in the metro area by $2.40.
- Time Warner installers go door-to-door to Everest customers offering to switch service and give three months of free service.
- Time Warner negotiates long-term contracts for exclusive access to MDUs, before wiring the buildings, and in some cases for the life of the Time Warner franchise plus any renewals.
- Time Warner refuses to make local sports channel, Metro Sports, available to Everest.
- Everest filed a complaint with the FCC against Time Warner for violating 47 CFR 76.984 (filed February, 2002, alleging predatory pricing).

Texas (Austin, San Antonio, and San Marcos)

Competitive Service Provider: Grande Communications

- In a potential violation of the uniform rate provisions of the Cable Act and without a determination of "effective competition" in the area, Time Warner engaged in improper "win-back" practices and provided improper discount cable packages, not made openly to all cable customers. Their discounted pricing scheme is publicized only to those

individuals living in areas service by Grande who have switched services from Time Warner.

- Time Warner offers a digital package with expanded basic and digital tier service for $29.95 per month, a discount of $16.68 per month, or $200 per year. Time Warner offers the same package with HBO and Showtime for $46.94. The rate card is $74.52 for this service. These discounts follow Time Warner rate increases of $2 in August 2001 and again in January 2002, and are not available to all Time Warner customers.
- Their discounted pricing scheme "is not a true promotion. There have been neither advertisements in the local media alerting the public to the discount not any fliers in Time Warner's monthly billing statements describing the deal. In fact, customers who have contacted Time Warner directly have been unable to confirm not only the plan terms, but that the plan exists at all. The pricing scheme is being administered under the table. It is publicized only to those individuals living in areas serviced by Grande who have switched service from Time Warner." (Comments from City of Austin to the Federal Communications Commission, February 1, 2002).
- Grande Communications filed a Complaint with the FCC alleging that Time Warner engaged in anticompetitive practices, violating FCC regulations.
- Time Warner filed with the FCC Petitions for Effective Competition Status in Austin, San Marcos, and San Antonio (CSR-5701-E, filed May 4, 2001), even though its rivals serve only a fraction of the households.66 Austin, San Antonio, and Grande Communications filed opposition comments with the FCC in response, with the City of Austin citing Time Warner's practices with regard to Grande as an example of the competitive landscape that would result if Time Warner was granted effective competition status. The City argued that the aggressive, and possibly illegal, pricing was "just one reason why the FCC should continue to protect Grande until they grow in size and resources." Time Warner based its petition on a rule that allows cable companies to seek "effective competition" status if a local-service phone company begins offering video programming in a market. The FCC has yet to rule on the petition.

North Carolina (Charlotte, Raleigh, and other communities)

Competitive Service Provider: Carolina Broadband

- Time Warner aggressively secured long-term exclusive access contracts with MDU' – which comprise 30 percent of the market – before Carolina Broadband began providing service. Time Warner threatened to disconnect cable services if MDU management did not agree to sign 5+ year agreements.
- Carolina Broadband is on "hiatus" due to effect of anticompetitive conduct (lack of access to MDU's, and discriminatory pole access fees and policies).

Columbus, Ohio

Competitive Service Provider: WideOpenWest

66 The City of Austin reported that "out of an estimated 265,000 households in Austin, only 13,000 households – less than 5% -- even have access to Grande's services."

- Time Warner offers a 50 percent reduction in price of all cable services, but only for current customers of competitor.
- Time Warner customer service representatives have separate offer sheets for callers who identify themselves as WideOpenWest customers.
- Time Warner offers large discounts on Internet/digital data services to WideOpenWest customers (published rates of $49.95 and $14.95 per month for Internet and digital cable, respectively, reduced to $25 for both services for WideOpenWest customers only).
- Time Warner representatives engage in scare tactics (e.g., telling WideOpenWest customers that the transfer of systems to WideOpenWest will cause service disruptions, that WideOpenWest will be going out of business soon, etc.)

Mediacom Corporation

Algona, Iowa

Competitive Service Provider: Algona Municipal Utilities

- Mediacom telemarketers target AMU customers with offers of expanded basic cable service for $19.90 per month, and expanded basic digital cable service for $24.95 per month, with prices guaranteed for one year.
- While Mediacom's rates elsewhere continue to soar, in Algona they have fallen and certain citizens are receiving "all but free" service from Mediacom. AMU reports that Time Warner has waived "past due" balances and extended deeply discounted rate programs via coupons that are not made generally available to other subscribers.

Armstrong, Iowa

Competitive Service Provider: Independent Networks

- Mediacom targets competitor's customers in door-to-door campaign with offers of expanded basic digital cable service for $12.50 per month, with "Amnesty on Back Balances."
- Prices for digital service, which the competitor does not provide, are not discounted.

Emmetsburg, Iowa

Competitive Service Provider: n/a

- The Emmetsburg City Council questioned a Mediacom government relations official about why pricing in nearby towns (Spencer, Armstrong, and Laurens) was much lower than rates for Emmetsburg. Mediacom's representative stated that Mediacom's prices were low in areas where there is competition, and will remain so until the competition is driven out (after which Mediacom will raise rates "to the same place as everywhere else.") This statement evidences the intention (running competitive municipal

overbuilders out of business), and the strategy for doing so (lowering prices to an economically irrational level).

Harlan, Iowa

Competitive Service Provider: Harlan Municipal Utilities

- Mediacom offers expanded basic digital cable service (plus Starz and Encore movie channels) for $20.99 per month. Modified basic service (30 channels, no movies) is offered for $17.80 per month.

Laurens, Iowa

Competitive Service Provider: Laurens Municipal Communications Utility

- Mediacom offers all cable and Internet access services to new customers at a 50 percent reduction for six months. Expanded basic service is $21.25.

Muscatine, Iowa

Competitive Service Provider: Muscatine Power and Water

- Incumbent67 offers "digital gold" cable programming package for $25.75 per month for six months, along with three pay-per-view movies.
- Incumbent offers "Switch Back Offer. A $200 value!!"
- In September, 2000, Incumbent expanded basic digital cable service for $19.95 per month, guaranteed for 12 months, for new cable customers in Muscatine only.
- Flyer announcing a promotional offer states: "Keep this Between Us" and "Don't tell your out-of-town friends, but AT&T is offering **incredibly low prices** for digital cable TV **here in Muscatine**" (emphasis in original).

Spencer, Iowa

Competitive Service Provider: Spencer Municipal Utilities

- Starting June 2000, Mediacom offered SMU customers expanded basic analog service free for two months, then for $19.95 per month, upon written commitments by customers to continue service for 6 to 12 months. In August 2001, these "contracts" are "automatically extended" for another year, until July 2002. Price compares to Mediacom rate of $36.95 in Des Moines in 2002.

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67 Mediacom has purchased the Muscatine system from AT&T Broadband since these tactics began.

- Digital services are also discounted (e.g., $29.95 for digital service including one multi-screen movie package, including up to 16 movie channels. Regular rate is $51.95, as indicated in a flyer distributed in Armstrong, IA).
- During the winter and spring of 2001-2002, Mediacom targeted SMU customers with offers of
  - Amnesty on old unpaid bills if service is resumed with Mediacom,
  - All video services free for three months and half price for 3 additional months, and
  - Half price Internet access ($20.00 per month) for 6 months.
- Flyers were distributed to SMU homes ("ATTENTION: SMU Subscribers") announcing offers.

Storm Lake, Iowa

Competitive Service Provider: McLeod USA

- Mediacom offers all services to McLeod customers – analog, digital, high speed Internet access – at 50 percent reductions.
- Mediacom sales representatives visit McLeod customers at their homes and urge them to switch service because McLeod is bankrupt and no longer able to provide service. Other Mediacom reps tell McLeod customers that Mediacom is buying McLeod and customers can switch without contacting McLeod.