FEDERAL COMMUNICATIONS COMMISSION

47 CFR Part 76

[MM Docket No. 92–264; FCC 05–96]

Cable Television Horizontal and Vertical Ownership Limits

AGENCY: Federal Communications Commission.

ACTION: Proposed rule.

SUMMARY: The Commission seeks additional input on horizontal and vertical cable ownership limits to satisfy the legislative mandate in the Cable Television Consumer Protection and Competition Act of 1992 (1992 Cable Act) and the court's directives in *Time Warner Entertainment Co.* v. *FCC,* 240 F.3d 1126 (D.C. Cir. 2001) (*Time Warner II*). Section 613(f) of the Communications Act, enacted as part of the 1992 Cable Act, directs the Commission to conduct proceedings to establish reasonable limits on the number of subscribers a cable operator may serve (horizontal limit) and the number of channels a cable operator may devote to its affiliated programming networks (vertical, or channel occupancy, limit). The court in *Time Warner II* reversed and remanded the Commission's 30% horizontal ownership limit and its 40% channel occupancy limit. The Commission concludes that it is necessary to update and strengthen the evidentiary record, which must be sufficient to support revised ownership limits.

DATES: Comments are due on or before July 8, 2005, and reply comments are due on or before July 25, 2005.

ADDRESSES: You may submit comments, identified by MM Docket No. 92–264, by any of the following methods:

- Federal eRulemaking Portal: *http://www.regulations.gov.* Follow the instructions for submitting comments.
- Federal Communications Commission's Web Site: *http://www.fcc.gov/cgb/ecfs/.* Follow the instructions for submitting comments.
- People with Disabilities: Contact the FCC to request reasonable accommodations (accessible format documents, sign language interpreters, CART, etc.) by e-mail: *FCC504@fcc.gov* or telephone: 202–418–0530 or TTY: 202–418–0432.

For detailed instructions for submitting comments and additional information on the rulemaking process, *see* the **SUPPLEMENTARY INFORMATION** section of this document.

FOR FURTHER INFORMATION CONTACT: Barbara Esbin or Patrick Webre, Media Bureau, (202) 418–7200, or via Internet at *Barbara.Esbin@fcc.gov* or *Patrick.Webre@fcc.gov.*

SUPPLEMENTARY INFORMATION: This is a synopsis of the Commission's Second Further Notice of Proposed Rulemaking in MM Docket No. 92–264, adopted May 13, 2005, and released May 17, 2005. The complete text of this Second Further Notice of Proposed Rulemaking (*Second FNPRM*) is available for inspection and copying Monday through Thursday from 8 a.m. to 4:30 p.m. and Friday from 8 a.m. to 11:30 a.m. in the Commission's Consumer and Governmental Affairs Bureau, Reference Information Center, Room CY–A257, Portals II, 445 12th Street, SW., Washington, DC 20554. The complete text is also available on the Commission's Internet Site at *http://www.fcc.gov.* Alternative formats are available to persons with disabilities by contacting Brian Millin at (202) 418–7426 or TTY (202) 418–7365. The complete text of the *Second FNPRM* may also be purchased from the Commission's duplicating contractor, Best Copying and Printing, Inc., Portals II, 445 12th Street, SW., Room CY–B402, Washington, DC 20554, telephone (202) 863–2893, facsimile (202) 863–2898, or via e-mail at *http://www.bcpiweb.com.*

Synopsis of the Second Further Notice of Propose Rule Making (Second FNPRM)

I. Introduction

1. Pursuant to Section 613(f) of the Communications Act, which was enacted by the Cable Television Consumer Protection and Competition Act of 1992 (1992 Cable Act),[1] the Commission must conduct proceedings to establish reasonable limits on the number of subscribers a cable operator may serve (horizontal limit), and the number of channels a cable operator may devote to its affiliated programming networks (vertical, or channel occupancy, limit). Congress intended the ownership limits mandated by Section 613(f) to ensure that cable operators did not use their dominant position in the multichannel video distribution (MVPD) market, acting unilaterally or jointly, to unfairly impede the flow of video programming to consumers. At the same time, Congress recognized that multiple system ownership could provide benefits to consumers by allowing efficiencies in the administration, distribution and procurement of programming, and by providing capital and a ready subscriber base to promote the introduction of new programming services.

2. The Commission first established a 30% horizontal ownership limit and a 40% vertical ownership limit in 1993.[2] Initially, the horizontal limit prohibited any cable operator from serving more than 30% of all homes passed by cable. In 1999, the Commission revised the horizontal limit to permit a cable operator to reach 30% of all MVPD subscribers. The vertical limit bars cable operators with 75 or fewer channels from devoting more than 40% of their channel capacity to affiliated programming. For systems with more than 75 channels, the limit applies only to 75 channels. The United States Court of Appeals for the District of Columbia Circuit in *Time Warner Entertainment Co.* v. *FCC (Time Warner II)* reversed and remanded both limits.[3] In response, the Commission issued a Further Notice of Proposed Rulemaking (*2001 FNPRM*),[4] in which it solicited comment on the nature of the MVPD industry, industry changes since the 1992 Cable Act, how these changes affected the implementation of horizontal and vertical limits, and various proposals for a new horizontal limit.

3. None of the comments to the *2001 FNPRM* yielded a sound evidentiary basis for setting horizontal or vertical limits as demanded by the court in *Time Warner II.* The Commission subsequently sought to augment the record by means of a programming network survey [5] and an experimental economics analysis (the BKS Study) [6]. The programming network survey yielded little useful information. The BKS Study and a theoretical work of Adilov and Alexander [7] suggest that,

[1] Cable Television Consumer Protection and Competition Act of 1992, Pub. L. 102–385, 106 Stat. 1460; Communications Act of 1934, 47 U.S.C. 151, *et seq.* (Communications Act).

[2] *Second Report and* Order, 58 FR 60135, November 15, 1993.

[3] 240 F.3d 1126 (D.C. Cir. 2001). The D.C. Circuit upheld the underlying statute in *Time Warner Entertainment Co.* v. *United States,* 211 F.3d 1313 (D.C. Cir. 2000) (*Time Warner I*).

[4] 66 FR 51905, October 11, 2001. After the 2001 FNPRM, the Commission issued an Order which suspended the elimination of the broadcast single majority shareholder exemption pending the outcome of this proceeding. FCC 01–353, 16 FCC Rcd 353 (2001).

[5] Letter from W. Kenneth Ferree, Chief, Cable Services Bureau, FCC, to Programming Network Owners (Feb. 15, 2002).

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

[7] Nodir Adilov & Peter J. Alexander, *Asymmetric Bargaining Power and Pivotal Buyers,* FCC Media Bureau Working Paper No. 13 (Sept. 2002) (Asymmetric Bargaining Power); Nodir Adilov &

under certain conditions, increased firm size can produce an improved bargaining position and adversely affect the flow of programming. However, these analyses of bargaining power are imprecise in determining the point at which such increased bargaining power impedes the flow of programming.

4. In addition to the deficiencies in the record, a number of significant events have occurred since the release of the *2001 FNPRM* that must be taken into account in fashioning cable ownership limits. First, the 2002 Comcast-AT&T cable transaction resulted in one entity having a share of MVPD subscribers very close to our remanded 30% ownership limit. Second, the 2003 News Corp.-Hughes transaction created the first vertically integrated DBS operator, involving a number of video programming assets. Third, courts have remanded media ownership rules in three decisions, requiring that the Commission more firmly base its rules on empirical data and record evidence.

5. The Commission concludes that a *Second FNPRM* is necessary and seeks comment on the proposals in the record, on recent developments in the industry, and on certain tentative conclusions. The Commission asks commenters to supplement the record where possible by providing new evidence and information to support the formulation of horizontal and vertical limits, and invites parties to undertake their own studies in order to further inform the record. The Commission also invites comment on Media Bureau Staff Research Paper No. 2004–1 (Survival Analysis), which examines the effect of subscribership on a network's ability to survive in the marketplace.[8]

II. Second Further Notice of Proposed Rulemaking

A. Legal Framework

6. The *Second FNPRM* in paragraphs 18 through 26 examines the statutory objectives of the 1992 Act, and discusses the Commission's previous efforts to implement the statute and judicial review of those efforts. The *Second FNPRM* in paragraphs 27 through 37 examines the elements of the horizontal and vertical limits in light of the stated objectives of the 1992 Act and the *Time Warner I*[9] and *Time Warner II* decisions. Section 613(f)(1) of the Communications Act directs the Commission to set horizontal and vertical limits in order to ''enhance effective competition.'' Section 613(f)(2) sets forth seven specific criteria and public interest objectives to be taken into account in setting horizontal and vertical limits. The *Second FNPRM* considers each of these criteria.

7. *Horizontal Limits.* In ruling that the Commission had failed to meet the required evidentiary standard, the court in *Time Warner II* stated that the Commission must base the limits on a ''non-conjectural risk'' of economic harm. In response to the *2001 FNPRM,* cable operators generally oppose the imposition of any ownership limits.

As discussed in paragraphs 39 through 44 of the *Second FNPRM,* the Commission tentatively concludes that the language of Section 613(f) requires us to set some limit on the number of MVPD subscribers one entity may reach, and that Congress gave the Commission significant discretion in determining the ownership limits, both in their absolute level as well as in their form and structure. The *Second FNPRM* seeks comment on the Commission's tentative conclusions.

8. *Vertical Limits.* In response to the *2001 FNPRM,* the Consumer Federation of America (CFA) argues that although horizontal market power is the primary focus of this proceeding, vertical market power is the driving force behind the horizontal ownership cap. CFA argues that vertical market power results in anticompetitive conduct, and that when dominant firms become integrated across markets for critical inputs, there are potential problems, and that vertical integration can create barriers to entry. However, CFA fails to offer any argument or evidence on how a channel occupancy limit can prevent the harms it alleges. Alternatively, commenters representing the cable industry argue that no vertical limit is necessary.

9. As discussed in paragraphs 45 through 48 of the *Second FNPRM,* the Commission observes that Section 613(f) directs us to establish a reasonable vertical limit, and we are not persuaded that ''reasonable'' can be construed as ''no'' limit. Thus, the Commission tentatively concludes that Section 613(f) requires the Commission to set both cable horizontal ownership and vertical channel occupancy limits at some number. The *Second FNPRM* seeks comment on how we can set both horizontal ownership and channel occupancy limits that will survive constitutional scrutiny in light of present circumstances.

B. Industry Developments

10. As discussed in paragraphs 49 through 58 of the *Second FNPRM*, there have been significant changes in the MVPD industry that bear upon the question of establishing reasonable cable horizontal and vertical ownership limits. The current MVPD market differs dramatically from that which existed when Congress enacted the subscriber and channel occupancy provisions of the 1992 Act. Cable operators, as well as other MVPDs, have been increasing their plant capacity, and have upgraded and enhanced system capabilities. As a result, MVPDs are offering substantially more programming networks and are rolling out new, advanced services to their customers, including digital tiers, video-on-demand and subscription video-on-demand. In addition to, and possibly as a result of the increased plant capacity of cable operators, the number of national programming networks has increased dramatically in recent years. Similarly, competition among programming networks and their diversity of source and content has increased. The *Second FNPRM* seeks comment on the effect that these developments, including the possibility of Internet-based distribution of programming, may have on the opportunity for independent programmers to gain distribution of their programming. It also requests information on plans cable operators may have to increase channel capacity further, and comment on the implications of such efforts.

11. *Unaffiliated Programming Networks.* Paragraphs 59 and 60 of the *Second FNPRM* examine some of the factors that have been integral to the success of new programming networks that are not affiliated with any cable operator. The *Second FNPRM* seeks comment on whether there is a relationship between ownership limits and the ability of independent programmers to gain carriage from cable operators, and remain independent, viable entities.

C. Economic Basis for Horizontal Limit

12. The *Second FNPRM*, in paragraphs 61 through 142 considers potential harms and benefits of horizontal concentration and proposed economic foundations for establishing a horizontal limit on cable operator size. None of the comments filed in response to the *2001 FNPRM* yields a sound

Peter J. Alexander, Most-Favored Customers in the Cable Industry, FCC Media Bureau Working Paper No. 14 (Sept. 2002).

[8] Keith S. Brown, *A Survival Analysis of Cable Networks,* Media Bureau Staff Research Paper No. 2004–1 (rel. Dec. 7, 2004) (Survival Analysis). The study is being placed in the record of this proceeding.

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

evidentiary basis for setting horizontal or vertical limits.

1. Defining the Market

13. The *2001 FNPRM* proposed a definition of markets in which the Commission distinguished between three separate but interrelated markets: The production of programming; the packaging of programming in networks; and the distribution of programming to consumers. While the Commission has received comments on these proposed market definitions, we find that some key questions remain unresolved. The *Second FNPRM* therefore seeks comment on certain questions and seeks further analysis and evidence to help resolve the issues raised.

(a) Programming Market

14. In response to the *2001 FNPRM*, one commenter argues that the Commission should not be concerned with networks' ability to enter the market, but instead should focus on program producers' ability to find outlets to distribute their programming to the public. Under this theory, the ability of networks to enter the MVPD marketplace would not be important if there are sufficient conduits for programming to reach consumers. If, on the other hand, networks play a significant role in developing and producing original and high quality programming, then the entry of new networks will encourage the production and distribution of new programming to consumers. The *Second FNPRM* seeks comment generally on the role that networks play in the production and distribution of programming, and on the role of niche networks in the development of genre-specific programs that may target audiences that are too small and specific to make them attractive to general entertainment networks or networks serving other genres.

(b) Programming Distribution Market

15. The Commission previously determined that the programming distribution market should be measured by the number of subscribers rather than the number of homes passed, and that DBS subscribers should be included in the count of total subscribers to which the limit is applied; that is, that the limit should be formulated as a percentage of all MVPD subscribers, rather than as a percentage of cable homes passed. The *Second FNPRM* seeks further comment on the appropriate definition of the programming distribution market, and tentatively concludes that other physical conduits such as theatrical showings in movie theaters and sales and rentals of VHS tapes and DVDs, should not be considered part of the same market of programming network distribution.

(c) Relevant Geographic Markets

16. In the *2001 FNPRM*, the Commission recognized that ''[t]he geographic market for certain types of niche programming may * * * be national or international in scope'' and sought comment on this conclusion. Some commenters allege that the market for programming is international. Other commenters say the Commission should also consider regional markets. The Commission continues to find it reasonable to concentrate our inquiry on the effects of cable concentration in the United States, and ask for comment on this tentative conclusion. The Commission also believes that regional markets may be relevant when considering programming that is only of interest to, or available in, a particular region. The *Second FNPRM* seeks comment on whether and how the existence of regional markets should affect the Commission's development of horizontal and vertical limits. Specifically, the *Second FNPRM* asks whether a regional limit on concentration would better effectuate any of the statutory purposes set forth in Section 613(f)(2), and if so, under what circumstances, and what would be the measure?

2. Potential Harms of Horizontal Concentration

(a) Analytical Frameworks for Economic Analysis of Harms

17. In paragraphs 71 through 136 of the *Second FNPRM*, the Commission seeks further comment on the appropriate economic framework for determining whether, and at what level, a cable operator's size is likely to impede the flow of programming to consumers or diminish effective competition, and discusses the strengths and weaknesses of a number of proposed analytical frameworks and economic theories.

(1) Open Field Approach

18. In 1999, the Commission adopted horizontal limits based on a theory that cable operators at certain concentration levels could effectively prevent programming networks from entering or surviving in the marketplace simply by deciding not to carry them. The Commission found that a new programming network needs to have access to 15 to 20 million subscribers and that the typical programming network had only a 50% chance of actually reaching all available MVPD subscribers. The Commission concluded that a programmer needed to have an ''open field'' of 40% of MVPD subscribers nationwide and that a 30% MVPD subscriber limit would assure that a 40% open field remained even if the two largest cable operators decided not to carry it.

19. The *Time Warner II* court rejected certain aspects of this approach, finding that the Commission lacked any evidence that cable operators would collude and that it could not simply assume that cable operators would coordinate their behavior. Further, the court held that Section 613(f)(1) does not authorize the agency to regulate the ''legitimate, independent editorial choices of multiple MSOs.'' Thus, the court found that the record supported only a 60% limit under the Commission's 40% open field premise. However, the court did not reach the question of whether the 40% open field assumption was reasonable. The court stated that on remand the Commission should take into account the effects of retail competition from DBS and other MVPDs.

20. In response to the *2001 FNPRM*, several commenters claim that an open field approach cannot justify a horizontal limit. For example, commenters point out that many successful programming networks reach fewer than 15 million subscribers. Commenters also dispute the methods the Commission used to move from the 20% of the industry necessary for network survival to the 30% limit, such as the 50% success rate assumption, and theories of collusion. The statute does not refer to particular types of programming networks, but rather to programming generally. The simple fact that some networks may be able to survive with fewer subscribers than others does not invalidate the use of averaged data to fashion a limit. The *Second FNPRM* seeks comment on whether the Commission should focus its analysis on the minimum number of subscribers needed by an average network, or instead examine separately the requirements of networks with high-cost and those with low-cost programming.

21. The *Second FNPRM* seeks additional comment on whether the Commission should continue to use an open field approach. Commenters should focus on a programmer's ability to survive in the marketplace without carriage by the largest operator. Commenters advocating the use of an open field approach should also address how the Commission should determine the size of the open field, recognizing that different types of networks may

require different subscriber reaches to be viable, depending on the cost of the programming, the target audience, and projected advertising revenue.

22. While developing a defensible horizontal limit under the open field approach requires an analysis of the number of subscribers a programmer needs in order to remain viable, the record in this proceeding generated almost no comments from independent cable programming networks. In another proceeding, the Media Bureau released a report (*A La Carte Report*) on the efficacy of *a la carte* pricing (*i.e.*, offering networks on a per-channel basis rather than only as part of a package) in the pay-television industry. In that proceeding, several video programmers alleged adverse impacts of mandated *a la carte* or themed-tier offerings, and provided new and insightful data and information on the current real-world relationships between content providers and distributors.[10] The Commission finds this data relevant to our analysis of reasonable horizontal ownership limits and seeks comment on how it should be applied.

23. The *Second FNPRM* also seeks comment on whether the Commission should take steps to address the reliability of any subscriber data we may use in applying the horizontal limit, and whether the Commission should adopt its own data collection procedures to obtain industry-wide subscriber data. The *Second FNPRM* further seeks comment on the recently released Survival Analysis, which focuses on the actual failure and success rates of networks and the relationship of those rates to subscriber reach. The Commission seeks comment on the value of this method in developing a horizontal limit under the open field approach.

(2) Monopsony Framework

24. In response to the *2001 FNPRM*, some commenters argue that the market for programming does not meet the key conditions necessary for the applicability of the monopsony[11] model, in which a large purchaser of programming could cause harm to the market. On the other hand, Consumer Federation of America (CFA) maintains that a monopsonist would have the power to decrease programmers' output and the prices they receive. In paragraphs 85 through 89 of the *Second FNPRM*, the Commission seeks comment on the appropriateness of applying standard monopsony arguments to the Commission's analysis of the programming market, and on how monopsony power can be measured.

(3) Bargaining Power as a Source of Unilateral Anticompetitive Action

25. Bargaining theory is an alternative framework to the theory of monopsony for analyzing how a large purchaser of programming services could exercise market power and cause harm to the market. The *2001 FNPRM* suggested that at certain levels of concentration cable operators could use their bargaining power to force down the prices they pay for programming, which could harm the flow of programming. In paragraphs 90 through 96 of the *Second FNPRM,* the Commission explores bargaining power as a source of unilateral anticompetitive action, and discusses the inefficiencies that can arise in negotiations for carriage between programmers and MVPDs.

(a) The Use of Bargaining Theory To Establish New Limits

26. Cable industry commenters draw on the work of Alexander Raskovich[12] to argue that large firm size could, in fact, weaken a cable operator's bargaining position. Raskovich's model is a generalization of the work of Chipty and Snyder,[13] who construct a bargaining framework in which a program seller engages in simultaneous bilateral bargaining with multiple program buyers. As detailed in paragraphs 97 through 100 of the *Second FNPRM,* neither the Chipty and Snyder model nor the Raskovich model persuades the Commission that limits on cable operator size are unnecessary. The Commission finds it unlikely that bargaining power is symmetric across all buyers regardless of size. Adilov, using basic data from the BKS Study, estimates bargaining power directly.[14] Adilov's results reveal statistically significant differences in individual buyers' bargaining power, a result that is not consistent with an assumption of constant bargaining power across firm size. The data generated from the BKS Study also show that buyers and sellers did not split the economic surplus evenly under all conditions. The Commission seeks comment on the usefulness of bilateral bargaining theory in setting an ownership limit.

(b) Experimental Economics Study

27. In 2002, the Commission released the BKS Study, which concerns the extent to which different levels of horizontal concentration among MVPDs might affect the flow of video programming to consumers. The study, placed in the record of this proceeding, utilized the methodology of experimental economics, which examines economic interactions among market participants in controlled laboratory settings. Commenters to the *2001 FNPRM* raise several objections to reliance on the BKS Study in setting a horizontal ownership limit. The Commission recognizes that the BKS study has limitations; however, the Commission believes that experimental economics can be a useful tool for evaluating the effects of increasing concentration. The *Second FNPRM* seeks comment on whether the Commission should consider employing experimental economics for purposes of setting an ownership limit.

(c) Additional Factors in the Analysis

28. The *Second FNPRM* in paragraphs 105 through 136 discusses four factors that should be considered when designing, evaluating, and applying an analytical framework.

(1) The Impact of Competition at the Distribution Level

29. The *Time Warner II* court criticized the Commission for failing to examine whether cable operators had market power in the distribution market, and in particular, for failing to take into account the growth of competition from direct broadcast satellite (DBS) providers. In the *2001 FNPRM,* the Commission sought comment on the impact of DBS' growth and presence on cable operators' market power and on their incentive to choose programming for reasons other than quality. In response, cable commenters argue that the Commission must conduct a ''dynamic'' examination of market power, which would show that the Commission need not impose any limits, since programmers have so many different outlets for their product that cable operators hold no deleterious market power. These commenters maintain that because any dissatisfied cable customer can switch to DBS, cable operators have no incentive to lower the

[10] *See, e.g.*, Comments filed in MB Docket No. 04–207 (*A La Carte Proceeding*), Oxygen Comments at 2–8; A&E Comments at 15–25; Crown Media Comments at 7–12; TV One Comments at 1–3, Decl. of Larry D. Gerbrandt at 4–11.

[11] The term ''monopsony'' refers to the situation in which a firm is the only buyer in a market, and the term ''monopoly'' refers to the situation in which a firm is the only seller in a market.

[12] *See* Raskovich Comments, later revised and published as Alexander Raskovich, *Pivotal Buyers and Bargaining Position,* 51 J. of Indus. Econ. 4, 405–26 (Dec. 2003).

[13] Tasneem Chipty & Christopher Snyder, *The Role of Firm Size in Bilateral Bargaining: A Study of the Cable Television Industry,* 81 Rev. Econ. & Stat. 2, 326–40 (1999).

[14] Adilov *ex parte* statement (Jan. 9, 2003) (submitting Nodir Adilov, *Firm Size and Bargaining Power: A Non-Linear Least Squares Estimate from the Cable Industry,* Working Paper, Department of Economics, Cornell University (Nov. 2002)).

quality or quantity of programming. CFA, however, argues that DBS is not a substitute for cable, because of its higher price and quality, and that the rise of DBS competition has failed to limit cable rate increases. CFA points to survey data that show that rural areas often lack cable service, and that a large proportion of satellite customers live in rural areas. CFA claims that the survey data demonstrate that for most satellite customers cable is not a substitute.

30. The *Second FNPRM* seeks comment on CFA's arguments and evidence, especially in light of the rapid growth of DBS subscribership and recent changes in the prices and programming DBS operators offer. It also seeks comment on whether a dynamic analysis of the type envisioned by cable commenters is necessary, and comment on how the Commission could perform such an analysis. The *Second FNPRM* further seeks comment on the degree to which the presence of DBS distribution alternatives acts to curb cable operators' bargaining power in the total programming market, and on how the Commission can analyze the effects of competition in the MVPD market to establish a specific limit.

(a) Threshold Approach

31. Under the threshold approach, the Commission would determine the level of competition from DBS and other MVPDs necessary to prevent the harms identified by Congress in Section 613(f). As long as competition exceeded this threshold, no horizontal limit would be necessary. The *2001 FNPRM* proposed several measures that could be used in a threshold test and asked for comment on these. The *Second FNPRM* requests further comment on the threshold approach, as well as on whether the Implicit Lerner Index, the ''q'' ratio, the Herfindahl-Hirschman Index (HHI), or alternative measures of market performance could be used in the threshold approach.

(2) The Potential for Joint Action

32. The Commission in paragraphs 117 through 125 of the *Second FNPRM* asks whether Section 613(f)(2)(A) requires the Commission to examine the possibility of joint action, in which firms act to maximize their joint benefits by reducing competition, either through overt or tacit collusion. Because the language of the Act refers to cable operators' ''joint actions,'' and because the economics and legal literatures acknowledge the possibility of tacit collusion in certain circumstances, the *Second FNPRM* tentatively concludes that the Commission should determine whether joint action by cable operators is likely, and if we determine that it is likely, we should factor this into the analysis.

33. The Commission notes that an explicit agreement among firms in a given market may not be necessary for that market to be characterized by joint action. This kind of coordinated action, ''conscious parallelism,'' is difficult to detect or control. The *2001 FNPRM* sought comment and economic evidence on whether cable operators have the incentives to engage in collusive behavior, and on what kinds of coordinated or collusive conduct would be relevant to the establishment of a limit. The Commission is not persuaded by the comments received in response to the *2001 FNPRM* that argue that joint action could not occur under certain circumstances, and the *Second FNPRM* seeks further comment on whether cable operators have the incentive and ability to engage in joint action.

(3) The Impact of Independent Actions by Multiple Cable Operators

34. The Commission, in paragraphs 126 through 127 of the *Second FNPRM* asks whether there are theories addressing how multiple cable operators that are acting independently could unfairly impede the flow of programming. The *Second FNPRM* seeks comment on whether such theories would be consistent with the court's holding in *Time Warner II* that promoting diversity alone is not a sufficient basis for crafting a limit designed to address multiple cable operations' independent editorial choices. The Commission seeks comment on the ability of cable operators to identify networks that will be successful, and the cost to programmers and to consumers of cable operator errors in predicting the value of new networks. The Commission also requests information on whether the existence of DBS operators affects these relationships.

(4) The Impact of Vertical Integration

35. The *2001 FNPRM* asked whether large cable operators with programming interests would have an incentive to unfairly favor affiliated programming over unaffiliated programming, and whether they could withhold their affiliated programming from competitors in order to disadvantage or prevent entry by competing MVPDs. The *2001 FNPRM* also asked if vertically-integrated cable operators could use their size to gain large programming license fee discounts and exclusive contracts with nonaffiliated programming, and whether this would harm rival MVPDs, lessen competition, and reduce the flow of programming to consumers. The Commission, in paragraphs 128 through 136 of the *Second FNPRM* finds the studies and analysis submitted in the record on the issue of vertical foreclosure to be insufficient, and seeks further comment and empirical evidence on the likelihood of vertical foreclosure and the ability of a horizontal limit to reduce that likelihood.

(a) Empirical Studies of Foreclosure

36. In response to the *2001 FNPRM,* empirical studies were submitted to the Commission that examined whether vertically-integrated cable operators have favored their affiliated programming services and are likely to do so in the future. However, since the industry has undergone tremendous change since these studies were performed, the Commission tentatively concludes that these studies are of little probative value in our analysis. The *Second FNPRM* asks in paragraph 135 for more evidence that alternative distribution channels are available to the kinds of new programming found on cable TV, and will provide sufficient revenues to provide a means of entering the market. The Commission also asks whether a programming network could make use of these alternative distribution channels for distributing its regular programming, as opposed to a program producer attempting to distribute a single piece of programming, such as a movie.

37. The Commission finds that cable operators potentially have an incentive to engage in vertical foreclosure, and that the evidence presented about their past behavior does not rule out the possibility that a cable operator of larger size could, in the future, have the incentive and ability to discriminate against or foreclose an unaffiliated network. The *Second FNPRM* seeks comment on independent analyses that have been performed on this issue since the close of the comment period in the *2001 FNPRM.*

3. Potential Benefits of Horizontal Concentration

38. The *2001 FNPRM* asked about the benefits of horizontal concentration, such as economies of scale, development of new programming, digital deployment, and investment in non-video services. Some commenters claim that concentration would bring such benefits. The *Second FNPRM* in paragraphs 137 through 142 discusses some theoretical benefits of concentration; however, the Commission has no evidence that would

help us identify these benefits or evaluate them at concentrations higher than those that exist today. Further, many of the purported benefits such as high-speed Internet, digital cable and telephony services are emerging at current levels of concentration, and the Commission tentatively concludes that further concentration is not necessary to speed development and delivery of these services.

39. Some commenters argue that high levels of concentration may provide direct benefits to programmers, in particular by better enabling programmers to recover their costs. Commenters also argue that increasing concentration can help solve the potential problem of multiple small cable operators attempting to free ride on the payments made by other cable operators, in which each cable operator forces down the price it pays to a level that fails to cover an adequate share of the fixed costs. The realization of this potential benefit, however, depends upon several factors that are not likely to occur in practice. The *Second FNPRM* tentatively concludes that commenters have not demonstrated that allowing a cable operator to become large enough to become a ''pivotal buyer'' will improve the flow of programming, and should therefore not be counted as a benefit of increased horizontal concentration.

D. Vertical Limit

40. Section 613(f) of the Communications Act directs the Commission to ''prescribe rules and regulations establishing reasonable limits on the number of channels on a cable system that can be occupied by a video programmer in which a cable operator has an attributable interest.'' In 1993, the Commission set a 40% limit on the number of activated channels that can be occupied by a cable operator's affiliated video programming services. The *Time Warner II* decision reversed and remanded the 40% channel occupancy limit, finding that the Commission had failed to justify its vertical limit with record evidence, and had failed to adequately consider the benefits and harms of vertical integration or current MVPD market conditions in its analysis. The *2001 FNPRM* sought comment on how the Commission could fashion meaningful and relevant channel occupancy limits given the changes that have occurred in the MVPD industry.

41. As discussed in paragraphs 143 through 147 of the *Second FNPRM,* several commenters assert that the Commission should not adopt any channel occupancy rules and should not limit the carriage of affiliated programming. Other commenters, however, assert that horizontal concentration and vertical integration in the MVPD industry require that the Commission enact and enforce a strict channel occupancy limit.

42. Both Congress and the Commission have long recognized that vertical integration produces efficiencies in the production, distribution, and marketing of video programming; however, we have also been concerned that such integration may provide an incentive for cable operators to engage in strategic, anticompetitive behavior. The economics literature provides support for both propositions, yet none of the comments filed in response to the *2001 FNPRM* yielded a sound evidentiary basis for either retaining the current vertical limit or for setting a different limit. Nonetheless, the Commission disagrees with commenters who assert that the Commission should not adopt any channel occupancy rules and should not limit carriage of affiliated programming, finding that the Commission is bound to follow Congress' statutory directive that a vertical limit be set. The Commission requests comment and empirical and theoretical evidence to assist in the development of reasonable limits and in the articulation of how such limits address the statutory goals.

1. Defining the Market

43. In paragraphs 148 through 149, the *Second FNPRM* seeks comment on how to define the programming and distribution markets for the purposes of determining an appropriate vertical limit. The *2001 FNPRM* proposed that programming could be classified into two broad categories, general entertainment and niche programming. The *Second FNPRM* asks whether the market for programming should be segmented according to the type of programming network involved. It also seeks comment on whether placement of networks on different tiers affects how vertical foreclosure might be implemented by a cable operator, and whether the Commission's rules should be applied on a tier-specific or package-specific basis.

2. Potential Harms of Vertical Integration

44. The *2001 FNPRM* asked commenters to ''address the economic basis underlying the concern with vertical integration and market foreclosure'' and whether the necessary conditions existed in the MVPD industry for cable operators to profitably engage in vertical foreclosure, and for this foreclosure to be harmful to the flow of programming. The Commission also sought comment on whether current and likely future developments in the MVPD market will mitigate past concerns regarding the ability of cable operators to discriminate against unaffiliated programming networks. In their responses to the *2001 FNPRM,* cable operators point to market factors that make vertical foreclosure unlikely. The *Second FNPRM* again seeks empirical, theoretical and anecdotal evidence to support the Commission's effort to carry out its statutory mandate in setting a vertical limit.

3. Potential Benefits of Vertical Integration

45. The *2001 FNPRM* sought comment on what impact relaxing or modifying the current limit might have on producing economic efficiencies, fostering innovation in services, and encouraging greater investment in and development of diverse and responsive programming. In response, cable commenters argued that vertical integration provides efficiencies by increasing the likelihood of financing for new networks and reducing the likelihood of ''hold-up.'' They also argue that it eliminates the problem of double marginalization, which occurs when both upstream and downstream firms attempt to exercise market power by charging above-cost prices. Commenters failed, however, to demonstrate that the benefits of vertical integration will always exceed the potential harms from vertical foreclosure. The Commission thus seeks further comment on whether and when the benefits of vertical integration mitigate the potential harms that might result, either generally or for particular vertical combinations.

46. The literature indicates that historically, content providers have received benefits from vertical integration with distributors. In the multichannel video programming industry, three kinds of benefits can result from vertical integration: transaction efficiencies, enhanced availability of capital and creative resources, and risk reduction through signaling commitment. The *Second FNPRM* examines each of these benefits in paragraphs 154 through 162.

E. Diversity of Information Sources

47. Section 612(g) of the Communications Act provides that at such time as cable systems with 36 or more activated channels are available to 70% of households within the United States and are subscribed to by 70% of

those households, the Commission may promulgate any additional rules necessary to promote diversity of information sources. In its *Eleventh Annual Report,* the Commission found that the first 70% threshold has been met, but that the second 70% threshold has not been met.[15] The Commission seeks comment in this proceeding on whether Section 612(g) would provide an independent or complementary statutory basis to limit cable operators' horizontal or vertical ownership interests, should the Commission determine that the second threshold has been met.

III. Procedural Matters

A. Comment Information

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

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

• For ECFS filers, if multiple docket or rulemaking numbers appear in the caption of this proceeding, filers must transmit one electronic copy of the comments for each docket or rulemaking number referenced in the caption. In completing the transmittal screen, filers should include their full name, U.S. Postal Service mailing address, and the applicable docket or rulemaking number. Parties may also submit an electronic comment by Internet e-mail. To get filing instructions, filers should send an e-mail to *ecfs@fcc.gov,* and include the following words in the body of the message, ''get form.'' A sample form and directions will be sent in response.

• Paper Filers: Parties who choose to file by paper must file an original and four copies of each filing. If more than one docket or rulemaking number appears in the caption of this proceeding, filers must submit two additional copies for each additional docket or rulemaking number. Filings can be sent by hand or messenger delivery, by commercial overnight courier, or by first-class or overnight U.S. Postal Service mail (although we continue to experience delays in receiving U.S. Postal Service mail). All filings must be addressed to the Commission's Secretary, Office of the Secretary, Federal Communications Commission.

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

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

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

People with Disabilities: Contact the FCC to request materials in accessible formats (Braille, large print, electronic files, audio format, etc.) by e-mail at *FCC504@fcc.gov* or call the Consumer & Governmental Affairs Bureau at 202–418–0531 (voice), 202–418–7365 (TTY).

B. Paperwork Reduction Act

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

C. Ex Parte Information

50. This is a permit-but-disclose notice and comment rulemaking proceeding. *Ex parte* presentations are permitted, except during the Sunshine Agenda period, provided that they are disclosed as provided in the Commission's Rules.[16]

IV. Initial Regulatory Flexibility Act Statement

51. As required by the Regulatory Flexibility Act of 1980, as amended (RFA), the Commission has prepared this Initial Regulatory Flexibility Analysis (IRFA) of the possible significant economic impact on a substantial number of small entities by the policies and rules considered in the *Second Further Notice of Proposed Rulemaking* (*Second FNPRM*) Public comments are requested on this IRFA. Comments must be identified as responses to this IRFA and must be filed by the deadlines for comments provided on the first page of this document. The Commission will send a copy of the *Second FNPRM,* including this IRFA, to the Chief Counsel for Advocacy of the Small Business Administration (SBA).

Need for, and Objectives of, the Proposed Rules

52. Section 613(f) of the Communications Act is intended, in part, to foster a diverse, robust, and competitive market in the acquisition and delivery of multichannel video programming. Specifically, Section 613(f) requires the Commission to establish reasonable limits on the number of cable subscribers that may be reached through commonly owned or attributed systems (horizontal limits) and on the number of channels that can be occupied by the cable system's owned or attributed video programming services (vertical limits). Congress intended these limits to ensure that cable operators do not use their horizontal reach in the multichannel video distribution (MVPD) market, acting unilaterally or jointly, to unfairly impede the flow of video programming to consumers. However, Congress recognized that multiple system ownership could benefit consumers by allowing efficiencies in the administration, distribution, and procurement of programming, and by providing capital and a ready subscriber base to promote the introduction of new programming services. Pursuant to its statutory mandate, and balancing these competing interests, the Commission has adopted and periodically revised cable ownership limits.

53. The Commission first established horizontal and vertical ownership limits in 1993.[17] The horizontal limit bars cable operators from serving more than 30% of all U.S. MVPD subscribers. The vertical limit bars cable operators with 75 or fewer channels from devoting more than 40% of channel capacity to

[15] *See Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming,* 20 FCC Rcd 2755, 2767–68 para. 20 (2005).

[16] *See generally* 47 CFR 1.1202, 1.1203, 1.1206(a).

[17] *See Implementation of Sections 11 and 13 of the Cable Television Consumer Protection and Competition Act of 1992, Horizontal and Vertical Ownership Limits, Cross-Ownership Limitations, and Anti-trafficking Provisions,* 8 FCC Rcd 8565, 8567 paras. 3–4 (1993) (*1993 Second Report and Order*).

affiliated programming. In *Time Warner II,* the D.C. Circuit remanded the Commission's horizontal and vertical limits, finding that the horizontal and vertical ownership limits unduly burdened cable operators' First Amendment rights, that the Commission's evidentiary basis for imposing the ownership limits and its rationales supporting the vacated attribution rules did not meet the applicable standards of review, and that the Commission had failed to consider sufficiently changes that have occurred in the MVPD market since passage of the 1992 Act. The Commission thereafter issued the *2001 FNPRM* soliciting comment aimed at establishing a sound record on which to base cable horizontal and vertical limits.

54. None of the comments to the *2001 FNPRM* yielded a sound evidentiary basis for setting horizontal or vertical limits. The Commission concludes that a *Second FNPRM* is necessary to update the record and provide additional input on horizontal and vertical ownership limits so that the Commission may comply with the statutory mandate and the court's directives.

55. In the *Second FNPRM*, the Commission seeks comment on how recent developments in the industry may affect the issues before us. Additionally, to develop a more focused and useful record, the Commission addresses the viability of proposals for setting limits suggested in the record.

Legal Basis

56. The authority for the action proposed in this rulemaking is contained in Sections 2(a), 4(i), 303, 307, 309, 310, and 613 of the Communications Act of 1934, as amended, 47 U.S.C. 152(a), 154(i), 303, 307, 309, 310, 533.

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

57. The RFA directs agencies to provide a description and, where feasible, an estimate of the number of small entities that will be affected by the rules. The RFA defines the term ''small entity'' as having the same meaning as the terms ''small business,'' ''small organization,'' and ''small governmental jurisdiction.'' In addition, the term ''small business'' has the same meaning as the term ''small business concern'' under the Small Business Act, unless the Commission has developed one or more definitions that are appropriate to its activities.[18] Under the Small Business Act, a ''small business concern'' is one which: (1) Is independently owned and operated; (2) is not dominant in its field of operation; and (3) satisfies any additional criteria established by the SBA.[19] In paragraphs 8 through 11 of Appendix B of the *Second FNPRM*, the Commission discusses the various types of small entities that may be affected by the rules and policies in the *Second FNPRM*.

Description of Projected Reporting, Recordkeeping and Other Compliance Requirements

58. None proposed.

Steps Taken To Minimize Significant Impact on Small Entities and Significant Alternatives Considered

59. The RFA requires an agency to describe any significant alternatives specifically affecting small entities that it has considered in proposing regulatory approaches, which may include, among others, the following four alternatives: (1) The establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (2) the clarification, consolidation, or simplification of compliance or reporting requirements under the rule for small entities; (3) the use of performance, rather than design, standards; and (4) an exemption from coverage of the rule, or any part thereof, for small entities.[20]

60. The cable ownership limits are intended to prevent large cable entities from unfairly impeding the flow of video programming to consumers through their horizontal reach and/or their vertical integration. Any horizontal or vertical limits adopted by the Commission would directly impact large cable entities, and we anticipate that they will have little adverse impact on small entities. The *Second FNPRM* discusses several potential scenarios in which small entities may suffer harm from large entities, either through their horizontal reach, their vertical integration, or both, and seeks comment on crafting rules that prevent harms to small entities, which could, in turn, protect the flow of programming to consumers.

Federal Rules Which Duplicate, Overlap, or Conflict With the Commission's Proposals

61. None.

V. Ordering Clauses

62. Accordingly, it is ordered, that pursuant to authority contained in sections 2(a), 4(i), 303, 307, 309, 310, and 613 of the Communications Act of 1934, as amended, 47 U.S.C. 152(a), 154(i), 303, 307, 309, 310, and 533, this *Second Further Notice of Proposed Rulemaking* is adopted.

63. It is further ordered that, pursuant to the authority contained in sections 2(a), 4(i), 303, 307, 309, 310, and 613 of the Communications Act of 1934, as amended, 47 U.S.C. 152(a), 154(i), 303, 307, 309, 310, and 533, notice is hereby given of the proposals described in this *Second Further Notice of Proposed Rulemaking.*

64. It is further ordered that the Commission's Consumer and Governmental Affairs Bureau, Reference Information Center, shall send a copy of this *Second Further Notice of Proposed Rulemaking,* including the Initial Regulatory Flexibility Analysis, to the Chief Counsel for Advocacy of the Small Business Administration.

List of Subjects in 47 CFR Part 76

Cable television.

Federal Communications Commission.

Marlene H. Dortch,

Secretary.

[FR Doc. 05–11473 Filed 6–7–05; 8:45 am]

BILLING CODE 6712–01–P

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

[19] 15 U.S.C. 632.

[20] 5 U.S.C. 603(c).