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MEMORANDUM

TO: All Commissioners
FROM: James H. Quello
RE: Video Dial Tone Draft Order
DATE: July 9, 1992

I strongly support the concept of video dial tone (VDT). I believe it is vital for the Commission to move toward facilities-based competition with established multichannel providers and to facilitate broadband networks capable of providing a wide range of new services to consumers. With these goals in mind, I endorse VDT with the following caveats: (1) the Commission should avoid promoting a single wire, controlled by the telco, since it would be the greatest monopoly since the old Bell System; (2) the Commission should be careful not to undermine the franchising provisions of the Cable Act; (3) the Commission must ensure that telephone companies enter the business as common carriers only, and that they not become too enmeshed in the programming business; and (4) the Commission should not take drastic steps that could affect the viability of over-the-air broadcasting.

Given my policy inclinations, I have several concerns about the draft VDT item:

1. Although the order seeks to promote facilities-based competition, it may encourage the merger of alternative transmission systems. This item could lead to that result by allowing telcos to buy existing cable facilities and convert them to VDT networks. Such a result, according to the item, would be a marketplace decision with which we should not interfere. But we are not talking about a pure marketplace decision, since Commission policies would allow the buy-outs, allow extensive joint ventures, and reward cable operators who enter such arrangements by freeing them from cable franchise restrictions (see below). Changing the rural exemption to allow cable-telco mergers in communities of 10,000 or less would have the same effect. While we should consider a rural exemption for communities where there is no cable service, or to allow overbuilds, I am extremely hesitant to let telephone companies simply purchase existing systems.

2. I am concerned that the draft order may stray from the common carrier concept by allowing telephone companies to become far too involved in programming. This will occur in a number of ways:

— First, the telcos will be able to invest directly, up to 5%, in programming services. Thus, they could buy in to HBO or an established cable operator. But this is only a minor consideration compared to other programming issues.

— The draft order's exceptionally narrow definitions of "cable operator" and "video programming" will allow telephone companies to become deeply involved in programming issues. The Cable Act only prohibits telcos from providing video programming directly to customers. This item allows telcos to "provide directly" (100%) any kind of programming that was not available on cable in 1984. This means any interactive programming is allowed, most notably pay-per-view.

Although telcos may not "provide directly" traditional cable and TV services, they will be allowed as gateway providers to take service orders from subscribers, send an installation team, configure inside wiring and provide the converter box (or even a TV), determine which services are available through the gateway, organize how the services are presented to subscribers, handle billing and collection and retain a percentage of the proceeds.

— The order distinguishes between cable operators (which must obtain a franchise) and VDT gateway services (which do not require a franchise) by saying that the telco will not be able to engage in tiering, packaging or pricing traditional cable services. But the difference appears to be largely semantic. As a gateway provider, the telco will be able to select which information services (channels) will be available, group them on menus, and direct the customers to them through navigational aids.

I agree with our original decision that a common carrier VDT provider and its customer-programmers should not be required to obtain a cable franchise under the Cable Act. However, we increase the litigation risk in direct proportion to the extent we allow telephone companies to become closely involved in programming.

3. We should not allow our VDT decision to be a vehicle by which the Cable Act could be circumvented. If a cable operator sold his facilities to a telephone company, for example, he could then avoid all franchising obligations. As a "gateway provider" on the new VDT networks, the former cable operator would be freed from franchise restrictions, as well as our effective competition rules. (Incidentally, while VDT is a common carrier service subject to tariff, this does not mean that service prices are regulated. The price the telco can charge for carriage is regulated; the prices consumers pay for video channels are not). I strongly believe that there would be both policy and political ramifications to such a scenario that the Commission would be wise to avoid.

4. The Commission must take care not to create the incentive for telephone companies to discriminate. The existing rules were adopted because of the historic propensity of telcos to engage in cross-subsidies and discrimination. Assuming that safeguards can prevent such problems in the future — which is by no means a foregone conclusion — I am concerned that the draft may create additional *legal* ways to discriminate. Examples:

— Telcos can own 5% of programming services and they can pick and choose which channels will be available on their enhanced gateways. Also, telcos can discriminate in offering various gateway services (*e.g.*, providing billing and collection) to various providers. This gives telcos the power to demand 5% ownership as the price of gaining access to their gateways.

— Telcos can deny gateway access to programmers that compete with the ones in which they have invested. Given the range of services telcos can provide, failure to be on their gateway is likely to be a significant competitive disadvantage.

5. I think we must keep in mind that this order sets the blueprint for restructuring video delivery. In that connection, I believe it is essential that the American public continues to have access to a free system of of video information. While the common carrier concept is a form of must carry, the essential inquiry then focuses on the terms and conditions of access. On this important point, I have more questions than answers. For example, will the programming that is currently available off-air still be free? The item concludes only that local broadcasters will get no preferential treatment. Does this mean that Channel 50 has to pay the same for access as HBO? And if so, can the broadcasters on the wire continue to be free to the subscribers as they are now? Also, will telcos be able to manipulate broadcasters through tariff conditions, gateway restrictions, etc.?

I believe that there must be a way for broadcasters, who are licensed by the government to provide universal service to their communities, to be subject to separate tariffs at a rate that will allow them to continue to serve the public interest. I think the case for this is even more compelling in the case of public broadcasting. If, on the other hand, we are laying the groundwork for all video services to become pay services, we should be up front about it.

CONCLUSIONS

Based on these concerns, I think the draft approach to VDT should be modified in several ways. First, telephone comapnies should not be permitted to purchase existing cable facilities, and any rural exemption should be restricted to overbuilds and unserved areas. Second, telephone companies should continue to serve as common carriers, and not be allowed to become involved in programming. Third, while telcos should be allowed to provide enhanced services, we must recognize that, at some level of involvement with the delivery of video signals, the VDT provider may legitimately be considered a cable operator and subject to franchising requirements. Fourth, the definition of "video programming" proposed in the draft is far too narrow, and allows far too much editorial involvement by carriers. Fifth, the order should recognize the importance to the American public of universal free video service and should articulate a policy that will promote such service.

At the very least, I support Commissioner Duggan's suggestion that some of these questions should be put out for further notice. On some of the issues, such as acquisition of cable facilities by telephone companies, I see no need for further inquiry.

Ultimately, I will be able to support the VDT order if changes are made, as suggested above, or if some of the issues are deferred pending further inquiry.

I will be happy to discuss any of these issues.