Formalities and the Future: The Fate of Sections 411 and 412

A Future Without Formalities
Irwin Karp 521

Bamboozlement: The Repeal of Copyright Registration Incentives
John B. Koegel 529

The End of Formalities: No More Second-Class Copyright Owners
Arthur Levine 553

Registration and Remedies: Recovery of Attorney's Fees and Statutory Damages Under the Copyright Reform Act
Charles Ossola 559

Freeing Copyright From Formalities
Shira Perlmutter 565

The Futility of a Future Without Formalities
Bernard R. Sorkin 589

Note

Controlling Expression: The Stagnant Policy of the Centers for Disease Control in the Second Decade of AIDS
Jessica M. Tourk 595

CAN SHORT-TERM LIMITS ON STRATEGIC VERTICAL RESTRAINTS IMPROVE LONG-TERM CABLE INDUSTRY MARKET PERFORMANCE?

James W. Olson and Lawrence J. Spiwak*

I. Introduction

Historically, competition between rival distributors of delivered multichannel video programming has been less than robust.[1] Indeed, prior to 1992, nearly all cable firms enjoyed franchised monopolies in local distribution markets. Concerned about the market performance of the cable industry,[2] Congress passed the Cable Television Consumer Protection and Competition Act of 1992 ("1992 Act"),[3] which regulates the price, terms, and conditions of cable television service. In addition, the program access provisions, a major but less publicized portion of the 1992 Act, sought to promote entry into local distribution markets through interim limits on strategic vertical restraints between vertically-integrated cable operators and programmers.[4]

This article argues that by identifying and prohibiting for a limited period certain entry-deterring vertical restraints, Congress devised an important tool to implement the goal of improved long-term performance of the market for delivered multichannel video

* Mr. Olson graduated with an A.B. from the University of California, Berkeley in 1969 and a J.D. from the Yale Law School in 1972. Mr. Spiwak graduated with a B.A. from the George Washington University in 1986 and a J.D. from the Benjamin N. Cardozo School of Law in 1989. Mr. Olson is currently the Chief of the Competition Division of the Federal Communication Commission's Office of the General Counsel. Mr. Spiwak is currently a senior attorney with that Division. The views expressed herein do not necessarily reflect the policies of the Commission, any individual Commissioner, or the Office of the General Counsel. The authors would also like to thank their colleagues in the Competition Division for their helpful comments.

[1] For purposes of this article, the term "delivered multichannel video programming" is used to define the product available to the ultimate consumer. *See* Satellite Television & Associated Resources, Inc. v. Continental Cablevision of Va., Inc., 714 F.2d 351, 354 (4th Cir. 1983), *cert. denied*, 465 U.S. 1027 (1984) ("Programming and the transmission equipment are one product.").

[2] *See* House Comm. on Energy and Commerce, Cable Television Consumer Protection and Competition Act of 1992, H.R. Rep. No. 628, 102d Cong., 2d Sess. 26 (1992) [hereinafter House Report].

[3] Pub. L. No. 102-385, 106 Stat. 1460, amending the Communications Act of 1934, ch. 652, 48 Stat. 1064 (codified at 47 U.S.C. §§ 521-59 (Supp. V 1993)).

[4] *See* Communications Act § 628, 47 U.S.C. § 548 (Supp. V 1993); *see also* House Report, *supra* note 2, at 27 ("A principal goal . . . is to encourage competition from alternative and new technologies, including competing cable system[s], wireless cable, direct broadcast satellite, and satellite master antenna television services.").

programming.[5] Implicit in this approach is the belief that to improve market performance at the distribution level, entry should be vigorously promoted by eliminating vertical restraints to facilitate non-discriminatory access to cable programming—even at the expense of possible static economic efficiencies created by those vertical restraints. As explained below, such sacrifice may be necessary in order to achieve more significant dynamic economic efficiencies.

Specifically, although vertical relationships can often have procompetitive effects, under certain market conditions, strategic vertical restraints (achieved by vertical integration, exclusive distribution contracts, or monopsony pressure) can also deter entry into the distribution market for delivered multichannel video programming.[6] Accordingly, consistent with the trend in recent economic literature, the program access policy requires the Federal Communications Commission ("Commission" or "FCC") to balance the likely competitive harm to consumers created by a particular vertical restraint against the likely efficiency benefits arising from the transaction.[7] By requiring the Commission to identify and eliminate those vertical restraints that can impede entry into the distribution market (i.e., harm *competition*), the program access policy contributes to the long-term market performance of *both* the distribution market and the programming market, because the entry of competitors in the distribution market provides more outlets for programmers.

To show how the program access policy works, Part II first analyzes the economics of the market for delivered multichannel video programming, and explains how vertical restraints can provide both benefits and detriments for those involved. Part III examines the few cases in which rival distribution technologies sought (and largely failed) to obtain redress for alleged strategic vertical conduct under the antitrust laws. Finally, Part IV explains that because of the highly dynamic nature of the industry, the short-term public policy approach embraced by Congress is likely to be a more effective mechanism for improving long-term market performance than antitrust litigation.

II. The Economics of the Delivered Multichannel Video Programming Market

A. *Market Structure*

To examine how vertical restraints can create a barrier to entry for firms providing delivered multichannel video programming, it is first necessary to analyze the structure of the market. In the cable industry, there are two basic markets: the input (or upstream programming) market, and the output (or downstream distribution) market. The success of a multichannel video programming distributor ("MVPD")[8] depends, in large part, on its ability to attract subscribers through its programming offerings. The success of a programmer, on the other hand, depends on its ability to obtain carriage of its programming.

1. The Input Market: Programming

MVPDs provide a menu of differentiated products in the form of programming networks.[9] The types of programming offered by

[5] *See* Steven S. Wildman & Bruce M. Owen, *Program Competition, Diversity, and Multichannel Bundling in the New Video Industry*, *in* VIDEO MEDIA COMPETITION: REGULATION, ECONOMICS, AND TECHNOLOGY 249 (Eli Noam ed., Columbia Univ. Press 1985) ("An increase in the number of alternative sources of content and of gatekeepers and thus video content diversity is almost unanimously presumed to be beneficial. . . . Increased content diversity implies a closer matching of video products with consumer tastes, which generally improves consumer welfare."); Andrew A. Bernstein, Note, *Access to Cable, Natural Monopoly, and the First Amendment*, 86 COLUM. L. REV. 1663, 1687-88 (1986) ("There is no governmental interest in combatting vertical integration unless integrated operators actually have incentives to discriminate against programming of competitors, thereby reducing the level of diversity.").

[6] *See In re* Teleprompter, 87 F.C.C.2d 531 (1981). There, the Federal Communications Commission recognized over thirteen years ago that:

> [V]ertical integration has conflicting components, in terms of the incentives involved. While it may create a natural tendency for the systems involved to deal with affiliated enterprises, it is also the engine for the creation of new products and services to increase the value of the total package of services offered [to] the public. Given the conflicting incentives involved, we believe it would be inappropriate to conclude on any general basis that vertical integration is undesirable. *Rather, what appears to be required is scrutiny of particular aspects of these vertical relationships for adverse consequences.*

Id. ¶ 61 (footnotes omitted and emphasis supplied).

[7] In *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967), the Supreme Court held that vertical resale restrictions were to be viewed under a per se analysis. Following a decade of disagreement as to the scope and meaning of *Schwinn's* pronouncement, the Supreme Court in *Continental TV, Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977), overruled the per se rule announced in *Schwinn* and directed a return to a rule of reason analysis for evaluating vertical non-price restrictions. *Sylvania* marked the rise of the Chicago School, with its view that because vertical restraints usually create efficiencies and do not restrict output, those restraints should generally be lawful. *See, e.g.*, ROBERT H. BORK, THE ANTITRUST PARADOX 303 (1978). However, some more recent literature takes a middle ground, arguing that while vertical restraints can create economic efficiencies, the possible anticompetitive effects should not be summarily dismissed without careful examination. *See, e.g.*, Michael H. Riordan & Steven C. Salop, *Evaluating Vertical Mergers: A Post-Chicago Approach*, 63 ANTITRUST L.J. 513 (1995); Lawrence A. Sullivan, *Section 2 of the Sherman Act and Vertical Strategies by Dominant Firms*, 21 Sw. U. L. REV. 1227 (1992).

[8] A "Multichannel Video Programming Distributor" or MVPD is any "person, such as, but not limited to, a cable operator, a multichannel multipoint distribution service, a direct broadcast satellite service, or a television receive-only satellite program distributor, who makes available for purchase, by subscribers or customers, multiple channels of video programming." Communications Act § 602(12), 47 U.S.C. § 522(12) (Supp. V 1993).

[9] *See* David H. Waterman & Andrew A. Weiss, *Vertical Integration in Cable Television*, pa-

MVPDs include:

(1) re-transmission of local and nearby distant broadcast signals;
(2) cable-originated networks such as MTV or CNN; and superstations, such as WTBS and WGN;[10]
(3) dedicated channels, including public access, educational, local government, and leased access;
(4) premium networks such as HBO, Showtime, The Disney Channel, and some regional sports networks;
(5) "mini-Pay" networks such as Starz and Encore; and
(6) pay-per-view networks such as Viewers' Choice and Request Television.[11]

Programming networks in each category can select from a variety of entertainment options. For example, some networks use a single format, such as home shopping or movie exhibition, while others produce original programming, and still others use a combination of formats. Premium and pay-per-view services, such as HBO and Showtime obtain most of their programming directly from movie studios.[12] Sports programming services, on the other hand, compete with broadcasters for carriage agreements with professional sports teams and leagues as well as intercollegiate athletic associations.[13]

However, no matter what the programming content, the costs of creating a new cable network are relatively high. It is estimated that programming vendors who launched cable networks in the 1980s spent $20-50 million on average, and that during the 1990s the average pre-launch cost will be between $50-100 million.[14] Established and well-capitalized programming vendors such as Turner Broadcasting System, Inc., Tele-Communications, Inc., and International Family Entertainment, Inc. have used their existing libraries of programming or production infrastructure to launch new services such as Turner Classic Movies, Encore Media Corporation, or Cable Health Club.[15]

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[10] These superstations are local broadcast stations that are nationally distributed by common carriers via satellite to cable systems. *Id.* at 19.

[11] *Id.* at 19-20.

[12] *See generally* 2 CHARLES D. FERRIS ET AL., CABLE TELEVISION LAW: A VIDEO COMMUNICATIONS PRACTICE GUIDE ¶ 17B (Matthew Bender 1994).

[13] *See generally In re* Implementation of Section 26 of the Cable Television Consumer Protection and Competition Act of 1992: Inquiry into Sports Programming Migration, 9 F.C.C.R. 3440 (1994).

[14] Simon Applebaum, *New Nets Farm Out Chores*, CABLEVISION, May 6, 1994, at 20A.

[15] Richard Katz, *Aspiring Nets Won't Be Daunted*, CABLEVISION, May 6, 1994, at 9A.

Despite the costs (and risks) involved in launching new networks, a recent trade publication reported that the number of new cable channels continues to grow. According to this publication, between May, 1984 and February, 1995, more than thirty new programming networks have been launched, and over forty-seven new additional programming networks have been proposed.[16]

On the other side of the ledger are programming vendors' revenues, which come from a number of sources. Broadcast and cable programming service networks rely on a mixture of advertising, per subscriber fees, and/or lump-sum payments from cable companies for carriage of their programming services.[17] Pay cable channels, such as HBO, Showtime, the Playboy Channel, and the Disney Channel charge a subscriber fee.[18] Finally, religious, educational, and public affairs networks, such as C-SPAN, are supported entirely with cable-operator funds or viewer donations.

2. The Output Market: Distribution

There are a number of distribution technologies capable of delivering multichannel video programming to consumers. Each competing firm has different capacity and cost characteristics associated with its choice of technology, which, in turn, affect the final programming package offered to the ultimate consumer.

At present, the output market is generally dominated by incumbent cable operators who have been the primary—if not exclusive—suppliers of delivered multichannel video programming in almost all local distribution markets.[19] This dominant position, in large part, is the result of government intervention in the form of cable franchises.[20] Indeed, many cable franchises started as nothing more than monopolies granted and protected by municipal authorities, and it was not until the 1992 Cable Act that local authorities were prohibited from unreasonably refusing to award

[16] *Number of New Cable Channels Continues to Grow, Despite Setbacks*, COMM. DAILY, Feb. 14, 1995, at 2.

[17] *See* FERRIS ET AL. *supra* note 12 ¶ 17B.03[1][f].

[18] *Id.* ¶ 17B.03[1][d].

[19] *See In re* Implementation of Section 19 of the Cable Television Consumer Protection and Competition Act of 1992, Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, 9 F.C.C.R. ¶ 141, at 7513-14 (1994) [hereinafter 1994 Competition Report]; *see also* SENATE COMM. ON COMMERCE, SCIENCE AND TRANSPORTATION, S. REP. NO. 92, 102d Cong., 1st Sess. 8-11 (1991) [hereinafter SENATE REPORT].

[20] *See* BRUCE M. OWEN & STEVEN S. WILDMAN, VIDEO ECONOMICS 257 (Harvard Univ. Press 1992); Bruce M. Owen, *Determining Optimal Access to Regulated Essential Facilities*, 58 ANTITRUST. L.J. 887, 888 (1989) ("In the case of cable television service, local officials often grant de facto exclusive franchises to applicants who, among other things, make promises of in-kind contributions to the local government.").

competitive franchises to rivals in any given area.[21]

In its recent 1994 Competition Report, the FCC found that approximately 92.9 million homes are able to receive cable service (up from 86 million in 1990), which constitutes over ninety-six percent of all television households in the United States.[22] The Commission found that the total number of households subscribing to basic cable services has increased to approximately 57.4 million households, which is almost sixty percent of the television households in the United States (up from 51.7 million households and 55.8 percent of television households in 1990).[23]

Moreover, the Commission also found that competition from "overbuilders"—i.e., situations where second cable operators enter local markets in direct competition with incumbent operators—is "quite limited."[24] Fewer than fifty of the approximately 11,500 cable systems in the United States face direct competition from other cable systems for cable subscribers.[25]

While direct competition between traditional franchised cable systems is de minimis, several other alternative providers have emerged in the delivered video distribution market. For example, Direct Broadcast Satellite ("DBS") service was officially launched in June 1994 and is being rolled out around the country. As of year-end 1994, DBS distributors served approximately 600,000 subscribers, or slightly less than one percent of total MVPD subscribers.[26] Moreover, industry analysts forecast that by 1999, DBS service may serve over eleven million subscribers.[27]

Multichannel Multipoint Distribution Service ("MMDS") or "wireless cable" systems are increasing in number and in 1994 received substantial investment through public financing.[28] By the end of 1994, wireless cable operators also served approximately 600,000 subscribers.[29] Industry analysts forecast that by the year

[21] *See* Communications Act § 621(a)(1), 47 U.S.C. § 541(a)(1) (Supp. V 1993) ("A franchising authority . . . may not grant an exclusive franchise and may not unreasonably refuse to award an additional competitive franchise.") (codifying the Cable Act of 1992, Pub. L. No. 102-385, § 7, 106 Stat. 1460, 1483 (1992)).

[22] 1994 Competition Report, *supra* note 19, ¶ 18.

[23] *Id.* ¶ 19.

[24] *Id.* ¶ 60.

[25] *See* SENATE REPORT, *supra* note 19, at 13.

[26] Kent Gibbons, *DBS: We're Walking the Walk*, MULTICHANNEL NEWS, Jan. 16, 1995, at 3, 52. For these subscriber numbers, both the high-powered Ku-band DBS services offered by DirecTV and United States Satellite Broadcasting ("USSB"), and the medium-powered Ku-band service offered by PrimeStar Partners, L.P., are counted as "DBSs," although the latter operates in the Fixed Satellite Service ("FSS").

[27] Tom Kerver, *DBS Disagreements Emerge*, CABLEVISION, Nov. 14, 1994, at 6.

[28] 1994 Competition Report, *supra* note 19, ¶ 80.

[29] *Wireless Cable Futures*, WIRELESS CABLE INVESTOR, Apr. 25, 1994, at 2.

2002, wireless cable companies may serve nearly four million subscribers.[30] Another source of delivered multichannel video programming, Satellite Master Antenna Television systems, serves approximately one million subscribers.[31] Finally, local exchange carriers ("LECs") are beginning to construct and market video dial tone ("VDT") service in their local service territories.[32] While the Commission has granted several VDT authorizations at the time of this writing, these systems are still either in the construction or trial phase and have no substantial subscribership.[33]

B. *The Growth of Vertical Relationships in the Cable Industry*

During the 1980s, the cable industry witnessed a rapid acceleration in vertical integration. Prior to 1984, only thirty-eight percent (fourteen of thirty-seven) of the channels were vertically owned.[34] In contrast, sixty-four percent (twenty-one of thirty-three) of cable channels launched immediately after 1984 were vertically integrated. Furthermore, these channels enjoyed significantly higher subscribership (and correspondingly higher ratings) than non-vertically integrated channels.[35] As of 1994, twelve of the top fifteen most-watched services, according to prime time ratings, were vertically integrated, an increase from ten in 1990. Moreover, cable operators currently have interests in fifteen of the top twenty-

[30] PAUL KAGAN & ASSOC., 1995 WIRELESS CABLE DATA BOOK 22-23.

[31] 1994 Competition Report, *supra* note 19, ¶ 48.

[32] 1994 Competition Report, *supra* note 19, ¶ 15. Under the VDT regulatory framework adopted by the Commission in 1992, a local telephone company may make available to multiple service providers, on a nondiscriminatory common carrier basis, a platform capable of providing nondiscriminatory access to multiple video programmers and delivering video programming and other services to consumers located within its local telephone service area. *See In re* Telephone Co.-Cable Television Cross-Ownership Rules, Sections 63.54-63.58, Further Notice of Proposed Rulemaking, Second Report and Order, Recommendation to Congress, & Second Further Notice of Proposed Rulemaking, 7 F.C.C.R. 5781, 5783 (1992), *recon. pending, and appeal docketed sub nom.*, Mankato Citizens Tel. Co. v. FCC, No. 92-1404 (D.C. Cir. Aug. 26, 1994). The VDT framework is thus an exception to the general prohibition of cross-ownership of telephony and video programming service providers contained in section 613(b) of the Communications Act, 47 U.S.C. § 533(b). Under this provision, a common carrier is prohibited from providing video programming directly to subscribers in its telephone service area, either directly or indirectly through an affiliate owned by, operated by, controlled by, or under common control of the common carrier (the "cross-ownership ban"). However, several courts have recently found the cross-ownership ban to be unconstitutional. *See, e.g.*, US West, Inc. v. United States, No. 94-35775, 1994 WL 719064 (9th Cir. Dec. 30, 1994), *amended and superseded by*, 1994 WL 760379 (9th Cir. Feb. 17, 1995); Chesapeake & Potomac Tel. Co. of Va. v. United States, 42 F.3d 181 (4th Cir. 1994); Ameritech Corp. v. United States, 867 F. Supp. 721 (N.D. Ill. 1994).

[33] *See* 1994 Competition Report, *supra* note 19, ¶¶ 109-120.

[34] *See In re* Competition, Rate Deregulation and the Commission's Policies Relating to the Provision of Cable Television Service, 5 F.C.C.R. ¶ 79, at 5007-08 (1990) [hereinafter 1990 Cable Report].

[35] *Id.* ¶ 80.

five services, an increase from thirteen in 1990.[36]

Vertical relationships, however, were not limited merely to vertical integration. Congress concluded that during the period 1984-1992, several cable operators required non-affiliated programmers to grant them exclusive rights to programming, a financial interest in the programming, or some other consideration if they wanted to be carried on a cable system.[37]

The increase in vertical restraints was accompanied by a corresponding increase in the number of complaints that vertically integrated cable operators engaged in some kind of anticompetitive conduct.[38] In particular, there were complaints during this period that cable operators either favored programming services in which they had interests, denied system access to programs affiliated with rival MSOs, and/or discriminated against rival programming services with regard to price, channel positioning, and programming.[39] Moreover, there were complaints that vertically-integrated firms denied rivals access to programming—a practice which deterred the development of new competition to the incumbent firms.[40]

C. *Efficiencies Created by Vertical Relationships*

To understand the motivation for vertical integration, it is first necessary to understand the concept of "sunk costs" and its relationship to market behavior. Generally, once committed, sunk costs cannot be costlessly redeployed for another use. Sunk costs generally take two forms: *exogenous* and *endogenous*. Exogenous sunk costs include irretrievable investments in production capacity, such as a cable operator's investment into headend and local distribution facilities, that are determined by factors ordinarily beyond the control of management. Cable network investment required by a franchise authority is an exogenous sunk cost.[41] In contrast, endogenous sunk costs are sunken expenditures on inputs of production that firms can vary with substantial discretion in pursuing business objectives. A good example of a major endogenous sunk cost in the cable industry is programming, because the spending committed to one type of programming cannot costlessly be redeployed to another type of programming.[42]

36 1994 Competition Report, *supra* note 19, ¶ 162.
37 SENATE REPORT, *supra* note 19, at 24; HOUSE REPORT, *supra* note 2, at 42.
38 *See* HOUSE REPORT, *supra* note 2, at 29-30.
39 HOUSE REPORT, *supra* note 2, at 41.
40 *See* 1994 Competition Report, *supra* note 19, ¶ 157; *see also* SENATE REPORT, *supra* note 19, at 26.
41 1994 Competition Report, *supra* note 19, at app. H ¶ 47.
42 *Id.* at app. H ¶ 46.

Vertical relationships, either as the result of vertical integration or exclusive distribution contracts,[43] can mitigate both distributors' and programmers' exposure to possible loss of the substantial sunk costs associated with investment in the creation and distribution of delivered multichannel video programming. Cable operators have large sunk investments in headend and local distribution facilities. The operator recovers these sunk costs by providing popular programming to its subscribers for a fee. Vertical integration reduces the risk to an operator of opportunistic behavior by a popular programmer who may raise its price to extract the value of accrued subscriber loyalty to the network after the initial distribution agreement expires. Similarly, vertical integration can reduce the risk of changing market conditions, such as a rise or fall in the quality of a network's programming, rapid technological changes that affect network or system costs, and a changing regulatory environment.[44]

Vertical integration can also benefit programmers. Considering the high sunk costs required to produce video programming (i.e., a Disney cartoon as a capital asset cannot be costlessly redeployed to produce "instructional television services"), arrangements for the outright sale of the assets are crucial to the producer's long-term viability. However, if the sunk investment is especially large, the programmer risks not being able to negotiate a contract that will provide sufficient recovery of all of the assets already sunk into the investment. Thus, given the huge sunk investment at risk, the programmer may find it cheaper to integrate rather than contract with an MSO. The larger the sunk investment, the larger the incentive to merge to ensure distribution of the product.[45]

43 Because exclusive dealing contracts are generally considered to be simply a form of vertical integration (and indeed may be measured by the same foreclosure theory used to analyze vertical mergers), the discussion about the benefits and harms of vertical integration applies equally to those created by exclusive distribution contracts. *See* BORK, *supra* note 7, at 303.
44 Waterman & Weiss, *supra* note 9, at 32.
45 *See* OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM 85-102 (Free Press 1985). As a related point, vertical integration can also mitigate "double marginalization." Specifically, a profit-maximizing monopolist in the supply market will charge a monopolist in the distribution market a marginal input price in excess of the marginal cost of producing the input. The higher input price, in turn, increases the cost of the downstream distributor. The profit maximizing downstream monopolist sets its marginal revenue equal to the marginal cost of production (which includes the mark-up of the upstream monopolist), raising the retail price and reducing the quantity sold to the end-consumer. If this double marginalization occurs, where the supplier takes the marginal revenue curve of the downstream firm as its demand curve, the combined profits of the manufacturer and retailer will be lower than if the input price was equal to the marginal cost of production. Vertical integration theoretically resolves this problem by internalizing the input

D. *Vertical Relationships as Barriers to Entry into the Distribution Market*

As stated above, because of the high sunk costs associated with the distribution of delivered multichannel video programming, a cable operator can mitigate the risk of losing this investment by taking advantage of vertical relationships. However, if the sunk costs at risk are substantial, the incumbent may also want to protect its sunk investment by engaging in entry-deterring strategies.[46] One of these strategies may be to use vertical relationships to foreclose rivals' access to important inputs in order to impede entry into the distribution market.

Barriers to entry are necessary for a firm with high market share to effectively exercise monopoly power.[47] In the absence of significant barriers to entry, a supplier probably cannot extract excess profits for a substantial period of time,[48] because any attempt to raise prices (or decrease services or quality) from competitive levels will lure into the market new competitors willing to offer similar services.[49] Indeed, because many competitive market theories establish a direct relationship between the number of firms supplying the market and the quality of market performance, it appears self-evident that any obstacle impeding the free and easy flow of new firms into the market must have a direct influence on market performance.[50]

The Department of Justice and Federal Trade Commission 1992 Horizontal Merger Guidelines also recognize the importance

pricing process so that true marginal costs are automatically reflected in the downstream retailer's final product-pricing decision. *See* Dennis W. Carlton & Jeffrey M. Perloff, Modern Industrial Organization 523-25 (2d ed. 1994).

46 1994 Competition Report, *supra* note 19, at app. H ¶¶ 36-37.

47 Over the last forty years, there has been a progressive refinement in the economic literature relating to the concept of "barriers to entry." In the 1950s, Joe Bain posited that there could be three sources of barriers to entry: (1) the absolute cost advantages of incumbent firms; (2) economies of scale; and (3) the product differentiation advantages of incumbent firms. *See* Joe S. Bain, Barriers to New Competition (1956). Later, in the 1960s, George Stigler contended that a barrier was a production cost "which must be borne by a firm which seeks to enter an industry but is not borne by firms already in the industry." George J. Stigler, The Organization of Industry 67 (1968). More recently, C.C. von Weizsacker further narrowed the definition, arguing that a barrier could be defined as "a cost of producing which must be borne by a firm which seeks to enter an industry but is not borne by firms already in the industry and which implies a distortion in the allocation of resources from the social point of view." C.C. von Weizsacker, *A Welfare Analysis of Barriers to Entry*, 11 Bell J. Econ. 400 (1980).

48 United States v. Syufy Enter., 903 F.2d 659, 664 (9th Cir. 1990); Ball Memorial Hosp., Inc. v. Mutual Hosp. Ins., 784 F.2d 1325, 1335-36 (7th Cir. 1986).

49 Metro Mobile CTS, Inc. v. New Vector Communications, Inc., 892 F.2d 62, 63 (9th Cir. 1989).

50 1994 Competition Report, *supra* note 19, at app. H ¶ 30.

of entry.[51] The Guidelines state that, ordinarily, a firm cannot create or enhance market power or facilitate its exercise if entry into the market is so easy that market participants, either collectively or unilaterally, could not profitably maintain a price above competitive levels or restrict output.[52] The Guidelines consider entry to be easy when entry would be timely, likely and sufficient in its magnitude, character and scope to deter or counteract the competitive effects of concern.[53] In markets where entry is that easy (i.e., where entry passes the test of timeliness, likelihood and sufficiency), there should be no competitive concern.[54]

However, the ability to freely exit is of equal importance to market performance. If it is costly to exit an industry, the incentives to enter are reduced. It is costly to exit an industry if there are sunk costs that cannot be recovered. Thus, if a firm contemplating entry into a market perceives that profit opportunities will be difficult to achieve, and therefore it is highly probable that the investment costs will be lost, the potential rival may decide not to enter.[55]

Clearly then, the presence of substantial sunk costs in the cable industry may influence the behavior of both incumbents and potential entrants. On the one hand, the incumbent wants to protect its sunk investments. On the other hand, a potential competitor's decision to enter a market depends on a cost-benefit analysis of the sunk costs it must invest to enter against the amount of sunk costs it is willing to lose. If the sunk costs implied by market entry are perceived as unreasonably large, then fewer firms will enter the market for multichannel video programming and competition will be reduced.[56]

An incumbent cable operator's ability to strategically use the presence of the substantial sunk costs inherent to the cable industry to deter a potential rival's entry decision can manifest itself in several ways.[57] For example, if an incumbent cable system, through

51 1992 Horizontal Merger Guidelines § 3.0, 57 Fed. Reg. 41,552 (1992).

52 *Id.*

53 *Id.*

54 *See id.*

55 Carlton & Perloff, *supra* note 45, at 111.

56 *See* 1994 Competition Report, *supra* note 19, at app. H ¶¶ 46-49.

57 As a related matter, vertical integration might permit a cable Multipe System Operator ("MSO") to avoid rate regulation under certain conditions. Specifically, maximum price regulation could permit a regulated, vertically-integrated MSO to pass on cost increases to subscribers by simply inflating the price it pays to its programming affiliate for internally supplied inputs. Indeed, in a recent article, Riordan and Salop recognized that "[r]egulatory agencies such as the FCC may have difficulty in policing these practices because of the absence of an independent market for comparable transactions." Riordan & Salop, *supra* note 7, at 561-62.

vertical relationships,[58] can impede or deter a potential entrant's ability to readily compile a package of programming at the production level, that rival may be forced to enter the industry at two separate levels simultaneously[59]—i.e., the potential entrant must commit substantial resources to construct *both* new distribution and programming facilities. Thus, if the prospective entrant must (or perceives that it must) incur sunk costs above what it can afford (or is afraid to lose), then the incumbent can deter entry and preserve its dominant share of the distribution market.[60]

An additional factor that can exacerbate the influence of sunk costs on entry decisions is the presence of product differentiation.[61] If incumbent firms are able to foreclose a potential entrant's access to established programming, the incumbent can differentiate its product from the potential rival's service. In general, consumer goodwill toward established programming makes it more difficult for new firms to enter. Thus, even if the potential entrant commits the irretrievable investments to the creation of substitute programming, the entrant faces higher marketing costs because it must compete against the incumbent operator's estab-

58 As stated above, vertical restraints can take the form of both exclusive contracts and outright integration. However, the mere presence of an MSO's monopsony power may vertically foreclose new entry by discouraging programmers from selling to rival distributors. For example, assume a very popular programmer several years ago entered into an exclusive distribution contract with a very large nationwide MSO. Through this relationship, the programmer was able to reach an exceptionally large audience and, with that audience, receive substantial revenues. However, the contract has now expired, and the programmer and the MSO are negotiating the next contract. In the meantime, a very small potential rival to the MSO located in a single location also wants to obtain the programming. Under such circumstances, it is highly unlikely that the programmer will want to jeopardize its profitable relationship with the national MSO just to sell to a single, small local competitor.

59 *See* Tom Krattenmaker & Steven Salop, *Anticompetitive Exclusion: Raising Rival's Costs to Achieve Power Over Price*, 96 YALE L. J. 209, 223-24 (1986); Michael L. Katz, *Vertical Contractual Relations*, *in* 1 HANDBOOK OF INDUSTRIAL RELATIONS 706-09 (Schmalensee and Willig eds. 1989); *see also* 1994 Competition Report, *supra* note 19, ¶ 230.

60 *See* Sullivan, *supra*, note 7, at 1245 ("[S]uccessful entry requires not only capital, but also information, talent and experience. Entrance to each level necessitates each of these components, and putting them together for a two-level entry is geometrically harder than putting them together for a one-level entry."); *see also* Katz, *supra* note 59, at 708. According to Katz, by "tying up all of the top-notch" inputs, exclusive dealing may enable an incumbent to deter entry from firms on the margin. Thus, Katz argues:

> [by] making small scale entry unprofitable, the incumbent (1) raises the financial risk (*i.e.*, sunk costs) of entry; (2) makes it more credible that the incumbent will not accommodate the entrant (the entrant has to get a large market share in order to survive and thus is a greater threat to the incumbent); and (3) makes it costlier to enter because growth takes time.

Id.

61 *See* J.A. Ordover et al., *Nonprice Anticompetitive Behavior by Dominant Firms Toward the Producers of Complementary Products*, *in* ANTITRUST AND REGULATION: ESSAYS IN MEMORY OF JOHN J. MCGOWAN 127-28 (Franklin M. Fisher ed., MIT Press 1985). ("[C]able television industry exhibited characteristics that may have created incentives for anticompetitive behavior toward rival producers of complementary products.").

lished programming. If the higher, per-unit selling costs necessary to overcome consumer preference for the incumbent's programming cannot be recovered by the potential entrant—i.e., are sunk—product differentiation can deter or impede entry.[62]

This conclusion is bolstered by a recent study which found that there was apparently an industry consensus that "the lack of more than one or two of the well-known networks such as ESPN, USA, CNN, and HBO would seriously handicap a multichannel competitor to an established cable system."[63] Thus, while the foreclosure of one channel may not be sufficient to raise a rival's costs so that entry is deterred, the inability to compile a "package" of the most popular cable channels (and the corresponding necessity—and risk—to commit large sunk costs to replicate this package) indicates that product differentiation on a sufficient scale can, in fact, impede or deter entry into the local distribution market.[64]

Accordingly, under certain conditions, vertical restraints that restrict a supplier's right to deal with competitors of a dominant downstream firm can have the effect of raising rivals' costs. Through such vertical relationships, a dominant firm can deter competitive entry and retain the power to raise prices or reduce quality in its output market.[65]

III. STRATEGIC VERTICAL CONDUCT AND THE ANTITRUST LAWS

As explained below, aggrieved rivals who argued that an incumbent cable firm illegally maintained its monopoly in the distribution market by foreclosing the rival's ability to obtain programming in the input market have put forward two basic—and related—theories under the federal antitrust laws. First, some plaintiffs argued that popular programming is an "essential" facility. Second, some plaintiffs argued that the incumbent violated the antitrust laws by entering into illegal exclusive distribution con-

62 *See* 1994 Competition Report, *supra* note 19, at app. H ¶ 40.

63 Waterman & Weiss, *supra* note 9, at 74 (footnote omitted).

64 One recent economic study raised two scenarios where vertical restraints can act as entry barriers. In the first scenario, vertical restraints deter entry into the distribution market because incumbent cable system operators effectively monopolize the market for packages of programming. In the alternative scenario, vertical restraints have the effect of monopolizing only the market for "cable channels," such as TBS, CNN, and "premium" movie channels such as HBO and Showtime. As a result, new entrants can enter the downstream markets by offering only "basic programming," consisting of retransmission of over-the-air programming and syndicated programming, such as old movies and reruns of old sitcoms. The net result, argues the study, is that in either scenario, a potential entrant is either excluded or disadvantaged by vertical restraints. *See* Michael H. Riordan & David J. Salant, *Exclusion and Integration in the Market for Video Entertainment Delivered to the Home*, Conference Paper, American Enterprise Institute (July 7, 1994).

65 1994 Competition Report, *supra* note 19, ¶ 230.

tracts with popular cable networks. However, as explained below, plaintiffs seeking such relief have met with little success.

A. *Popular Programming as "Bottleneck" or "Essential" Facilities*

Under antitrust law, the essential facilities doctrine is a potential theory for a claim of monopolization under section 2 of the Sherman Act.[66] The doctrine has four generally recognized factors: (1) the defendant is a monopolist in control of an essential facility; (2) competitors of the monopolist are unable to duplicate the facility; (3) the monopolist has refused to provide the competitor access; and (4) it is feasible for the monopolist to provide such access.[67] In addition, monopoly control of the upstream market may be a necessary element of an essential facility claim.[68]

Over the last several years, antitrust literature has suggested,[69] and courts have imposed, a very high standard as to what is "essential."[70] Indeed, recent decisions have been reluctant to find that even projects requiring large sunk investments should be considered "essential." For example, in *City of Anaheim v. Southern California Edison Co.*,[71] a municipal power supplier sued an investor-owned utility under section 2 for allegedly denying access to an "essential facility"—in this case, an interstate bulk power line. Use of the powerline was particularly desirable, because the user could import cheap hydroelectric power over the line.

Applying the standard outlined above, the court rejected the plaintiff's claims on two grounds. First, the court found that the power line could not be considered "essential," because there was "no dearth of available power" at reasonable cost.[72] As such, the court found the plaintiff's argument that a monopolist has "a duty to deal based on the extent to which a competitor might benefit if

[66] 15 U.S.C. § 2 (1988) ("[E]very person who shall monopolize or combine or conspire with any other person or persons, to monopolize and part of trade or commerce over the several states . . . shall be guilty of a felony . . . ."). To prove monopolization, a plaintiff must demonstrate: "(1) the possession of monopoly power in the relevant market; and (2) the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident." Eastman Kodak Co. v. Image Tech. Serv., Inc., 112 S. Ct. 2072, 2089 (1992); United States v. Grinnell Corp., 384 U.S. 563, 570-71 (1966).

[67] *See* City of Anaheim v. Southern Cal. Edison Co., 955 F.2d 1373, 1380 (9th Cir. 1992); Alaska Airlines Inc. v. United States Airlines, Inc., 948 F.2d 536 (9th Cir. 1991), *cert. denied*, 112 S. Ct. 1603 (1992).

[68] *Alaska Airlines*, 948 F.2d at 545 n.12.

[69] *See* Philip Areeda, *Essential Facilities: An Epithet in Need of Limiting Principles*, 58 ANTITRUST L.J. 841 (1989).

[70] *See, e.g.*, Olympia Equip. Leasing Co. v. Western Union Tel. Co., 802 F.2d 217 (7th Cir. 1986), *cert. denied*, 480 U.S. 934 (1987).

[71] 955 F.2d 1373 (9th Cir. 1994).

[72] *Id.* at 1381.

it had unlimited access to the monopolist's facility," rather than a "duty to deal based on the harm that would result to competition from the monopolist's refusal," turns "the essential facilities doctrine on its head."[73] Second, the court found that the utility had a legitimate business justification for refusing access to the line. The court found that this was not a situation where the capacity was not being used[74] or the sole reason for the denial of access was to maintain a monopoly.[75] Rather, the court found that this was a situation where the utility had a limited amount of capacity on the line and it desired to use that capacity to the limit when it could obtain inexpensive power. According to the court, when the utility can obtain less expensive inputs from the production market (i.e., cheap power) these savings can be

> rolled into its other costs and result[ ] in . . . savings to all of its customers. In this sort of regulated industry, it is certainly to the benefit of the monopolist's customers if its rates are as low as possible. Indeed, that is the major reason for the existence of regulatory commissions. . . . In other words, the public interest is well served when that happens, and that gives even more weight to the propriety of the refusal.[76]

Similarly, in *Alaska Airlines, Inc. v. United Airlines, Inc.*,[77] the Ninth Circuit found that computerized airline reservation systems were not "essential facilities" for purposes of section 2. In *Alaska*, several small airlines sued large carriers who owned and operated airline reservation systems. Under these systems, the large airlines were able to extract substantial "booking fees" from rivals for the use of their systems. The plaintiffs claimed that these substantial booking fees effectively denied them reasonable access to essential facilities, but the Ninth Circuit disagreed.[78] The court reasoned that the defendants' control of the reservation systems did not give them the power to eliminate competition in the downstream air transportation market because "basic economic theory tells us that [airlines] will withdraw from [the systems] if the cost of using either [system] causes the cost to the airline of providing a flight booked on a [system] to exceed the revenue that the airline gains

[73] *Id.* at 1380-81.

[74] *See, e.g.*, MCI Communications Corp. v. American Telephone & Telegraph, 708 F.2d 1081 (7th Cir.), *cert. denied*, 464 U.S. 891 (1983).

[75] *See, e.g.*, Otter Tail Power Co. v. United States, 410 U.S. 366 (1973).

[76] *City of Anaheim*, 955 F.2d at 1381 (citing Southern Pacific Communications Co. v. AT&T, 740 F.2d 980, 1009-10 (D.C. Cir. 1984), *cert. denied*, 470 U.S. 1005 (1985)).

[77] 948 F.2d 536 (9th Cir. 1991).

[78] *Id.* at 539.

by providing the flight."[79] The court held that because it was "difficult to imagine" that a travel agent would subscribe to a system if it only contained information about the defendants' flights, the ability of the defendants "to abuse their down stream competitors [was] severely limited."[80]

Moreover, the court noted that the defendants never actually refused plaintiffs access to the system, rather they simply gave them access for a fee.[81] The court noted that the defendants never had, nor were they likely to, set this fee at a level which would drive competing airlines away, as such action would "destroy their [systems] rather than the competition."[82] However, the plaintiffs argued that each system was an essential facility because each defendant's control of its system "gave it power to redistribute a portion of its rival's revenues to itself."[83] The court rejected this argument, finding that while

> each defendant may have gained some leverage over its competitors through control of [their systems] . . . each defendant's power fell far short of the power to eliminate competition. . . . At most, defendants gained a monetary profit at their rivals' expense. The exercise of this limited power is not actionable under Section 2.[84]

Courts adjudicating monopolization claims in the cable industry have been similarly reluctant to find that programming facilities should be considered "essential." For example, in *TV Communications Network, Inc. v. ESPN, Inc.*[85] a SMATV operator sued several programmers alleging a litany of monopolization claims under section 2. One of the plaintiff's claims was that ESPN, and its part owner ABC/Capital Cities, illegally monopolized the "market for the ESPN channel." The plaintiff also alleged that TNT illegally monopolized the market for the TNT channel.[86] In analyzing the plaintiff's essential facility claim under the standard outlined above, the court focused its inquiry on whether or not the plaintiff and the defendants were, in fact, competitors.[87] To do so, the court held that in determining whether entities are competitors,

79 *Id.* at 545.
80 *Id.*
81 *Id.*
82 *Id.*
83 *Id.*
84 *Id.* at 545-46.
85 767 F. Supp. 1062 (D. Colo. 1991), *aff'd*, 964 F.2d 1022 (10th Cir.), *cert. denied*, 113 S. Ct. 601 (1992).
86 *Id.* at 1071.
87 *Id.* at 1071.

"their relationship to each other is the critical factor, not the alleged effect of the arrangement."[88] According to the court, ESPN and TNT supply programming; the plaintiff was a SMATV operator. Therefore, according to the court:

> ESPN and TNT cannot occupy the same market level as [the plaintiff SMATV operator]. They occupy different market levels in the chain of distribution of programming. In relationship to each other, defendants ESPN and TNT and the plaintiff [SMATV] are vertical entities. Hence, ESPN has not denied an essential facility to a competitor. Any claim under this doctrine cannot stand.[89]

On appeal,[90] the plaintiff again argued that by entering into exclusive distribution agreements with incumbent cable operators, TNT had illegally refused access to an "essential facilit[y]."[91] In response, the Tenth Circuit found that "the use of antitrust 'buzz words' " did not supply the circumstances necessary to support the plaintiff's allegations.[92] According to the court, while it was "reasonable to infer that an entity would act to further its own monopoly power, it [was] implausible that the cable operator defendants would conspire with TNT to aid TNT in its efforts to acquire or to maintain a monopoly in the market for the TNT channel."[93] Thus, the court held that if TNT was "essential" to cable operators, then any conspiracy between the defendants "would actually be contrary to the interest of the cable operators . . . [because i]n such a monopolistic environment, TNT would have the power and incentive to charge cable operators supercompetitive prices for the TNT service."[94]

Similarly, in *Futurevision Cable Systems of Wiggins v. Multivision Cable TV Corp.*,[95] a cable system overbuilder brought an antitrust action against its competitors, two franchised cable operators, and several programmers who had previously entered into exclusive dealing contracts with the incumbent cable operators.[96] The overbuilder argued that the programmers' exclusive dealing con-

88 *Id.* at 1062 (citing Business Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717, 730-31 n.4 (1988)).
89 *Id.* (citations omitted).
90 TV Communications Network, Inc. v. Turner Network Television, Inc., 964 F.2d 1022 (10th Cir.), *cert. denied*, 113 S. Ct. 601 (1992).
91 *Id.* at 1025.
92 *Id.* at 1026.
93 *Id.*
94 *Id.*
95 789 F. Supp. 760 (S.D. Miss. 1992), *aff'd*, 986 F.2d 1418 (5th Cir. 1993).
96 *Id.* at 764.

tracts with the incumbents deprived the plaintiff of "the right to exhibit popular channel programming."[97] The incumbents moved to dismiss on the ground that this allegation did not state a claim, since under antitrust law the plaintiff had no such right.[98] According to the district court, section 2 prohibits refusals to deal if the denial violates the essential facilities doctrine.[99] However, the district court dismissed the complaint, finding that the plaintiff's

> own complaint makes clear that it has access to sufficient programming to allow it to enter, and succeed, in the relevant cable service markets without access to the Learning Channel or ESPN's Sunday Night Football. As such, any claim by the [plaintiff] that it has been denied an "essential facility" by the defendants in this case cannot stand.[100]

Indeed, the record in that case revealed that the plaintiff served approximately eighty-five percent, ninety percent, and eighty percent of the three markets in which it competed with the incumbent firm.[101]

B. *Exclusive Distribution Contracts*

In the past, the Supreme Court has often recognized that vertical restraints, even in the form of exclusive dealing arrangements, may have procompetitive effects and therefore should not be considered under the per se rule.[102] For example, in *Tampa Electric Co. v. Nashville Coal Co.*,[103] the Court rejected a claim that a twenty-year exclusive distribution contract violated the antitrust laws. According to the Court, the proper analysis involves weighing "the probable effect of the contract on the relevant area of effective competition . . . and the probable immediate and future effects which preemption of that share of the market might have on [the market] therein."[104] After finding under the facts of this case that the contract did not foreclose a significant portion of the relevant market, the Court upheld the contract.[105]

97 *Id.* at 771 n.7.
98 *Id.* at 765.
99 *Id.* at 778 n.12.
100 *Id.* at 778 n.12.
101 *Id.* at 769.
102 *See, e.g.*, Standard Oil Co. v. United States, 337 U.S. 293 (1949).
103 365 U.S. 320 (1961).
104 *Id.* at 329.
105 *See also* Satellite Television Associated Resources, Inc. v. Continental Cablevision of Va., Inc., 714 F.2d 351 (4th Cir. 1983), *cert. denied*, 465 U.S. 1027 (1984) (exclusive dealing requirement of cable company upheld where eight percent market foreclosure in relevant product and geographic markets would not substantially lessen competition).

Similarly, in *Continental T.V., Inc., v. GTE Sylvania, Inc.*,[106] the Supreme Court found that because non-price vertical restraints may create efficiencies under appropriate circumstances, such vertical restraints should be judged under a rule of reason analysis. According to the Court, the "market impact of vertical restrictions is complex because of their potential for a simultaneous reduction of intrabrand competition and stimulation of interbrand competition."[107] Specifically, the Court found that while vertical restrictions can reduce "intrabrand" competition (i.e., the competition between the wholesale or retail distributors of the product of a particular manufacturer) by "limiting the number of sellers of a particular product competing for the business of a given group of buyers," vertical restrictions can also promote "interbrand" competition (i.e., the competition among the manufacturers of the same generic product) by "allowing the manufacturer to achieve certain efficiencies in the distribution of his products."[108]

For example, the Court found that efficiencies from vertical restraints might include a new supplier's ability to induce distributors to make the "kind of investment of capital and labor that is often required in the distribution of products unknown to the consumer"[109] or to induce distributors to "engage in promotional activities or to provide service . . . necessary to the efficient marketing" of the product.[110] Moreover, the Court also found that because of "market imperfections such as the so-called 'free-rider' effect, these services might not be provided by retailers in a purely competitive situation, despite the fact that each retailer's benefit would be greater if all provided the services than if none did."[111]

Courts applying a rule of reason analysis to exclusive distribution contracts for cable programming have, with one exception, generally found that the procompetitive benefits of vertical restraints outweigh the anticompetitive harms. For example, in *Futurevision Cable Systems*,[112] the cable overbuilder's suit also included a claim under section 1 of the Sherman Act.[113] The overbuilder claimed that because the defendants had entered into an exclusive dealing contract for cable programming, such conduct constituted

106 433 U.S. 36 (1977).
107 *Id.* at 51.
108 *Id.* at 54.
109 *Id.* at 55.
110 *Id.*
111 *Id.*
112 789 F. Supp. 760 (S.D. Miss. 1992), *aff'd*, 986 F.2d 1418 (5th Cir. 1993).
113 *Id.* at 764.

an illegal restraint of trade.[114] According to the plaintiff, because of the "popularity of the programming (of ESPN and The Learning Channel), and the cumulative effect of this growing foreclosure to overbuilders, new entrants to the market . . . are placed at a serious competitive disadvantage in entering the markets served by the existing entrenched monopolies."[115]

The court, however, dismissed this claim. According to the court, the "critical analysis in determining the effects on competition of any vertical restraint requires a comparison of the effects on 'intrabrand' and 'interbrand' competition."[116] The court reasoned that as long as intrabrand competition acts as a significant check on the exploitation of interbrand market power, a supplier's termination of a distributor or dealer is not a violation of the antitrust laws because "any reduction in intrabrand competition would have, at most, a de minimis effect on the 'healthy' interbrand rivalry from the other dealers."[117]

Applying this reasoning to the facts of the case, the court found that the exclusive dealing contract at issue did not have an anticompetitive effect on interbrand competition.[118] Indeed, the court found that because the plaintiff served approximately eighty-five percent, ninety percent and eighty percent of the three markets in which it competed with the incumbent, the effect of the vertical restraint on interbrand competition could "hardly be characterized as anything other than insignificant," as the plaintiff "was apparently not foreclosed from competing in [the] market and obviously found alternative sources of supply in order to [service] cable subscribers. . . ."[119] According to the court, the plaintiff was still free to substitute other comparable programming "for that of The Learning Channel and ESPN Sunday Night Football."[120] Moreover, the court held that it was:

> quite reasonable to infer from Futurevision's allegations that the exclusive contracts have *increased* interbrand competition by causing overbuilders such as Futurevision to go to suppliers other than ESPN and The Learning Channel to purchase programming. From the cablevision viewer's perspective, it is equally clear that the exclusive contracts increase the diversity of programming available to the viewing public. Thus, while the vertical restraints in this case may eliminate some intrabrand competition, the court concludes that Futurevision's own complaint suggests they tend to "'be potentially beneficial to competition.'"[121]

114 *Id.*
115 *Id.* at 766.
116 *Id.* at 767 (citing Muenster Butane, Inc. v. Stewart Co., 651 F.2d 292, 296 (5th Cir. 1981)).
117 *Id.* at 767 (citing H & B Equip. Co. v. International Harvester Co., 577 F.2d 239, 246 (5th Cir. 1978)).
118 *Id.* at 770.
119 *Id.* at 769.
120 *Id.* at 770.

Similarly, in *TV Communications Network, Inc. v. Turner Network Television, Inc.*,[122] the plaintiff's suit also included a section 1 claim that TNT conspired with local wired cable operators to prevent the plaintiff from receiving TNT through an exclusive distribution contract. According to the court, however, section 1 of the Sherman Act only prohibits refusals to deal where a manufacturer has a monopoly in the relevant market.[123] In this case, the court found that because TNT was only the "manufacturer" of the TNT channel, it did not have any market share in the subscription television market (which, according to the court, was 100 percent controlled by cable companies). Thus, the court held that TNT's refusal to deal did not violate the antitrust laws.[124]

However, in *Storer Cable Communications, Inc. v. City of Montgomery Alabama*,[125] a cable overbuilder who claimed that two separate exclusive distribution contracts among a vertically-integrated MSO and ESPN and TNT, respectively, violated both section 1 and section 2 of the Sherman Act, survived a motion to dismiss. According to the plaintiff's complaint, the incumbent cable system, Storer Communications, provided cable television service to ninety-two percent of the market.[126] The plaintiff was an overbuilder who wanted to enter the market and compete with the incumbent. The plaintiff alleged that it sought to enter into long-term, non-exclusive distribution contracts with TNT and ESPN—both of which carried NFL Sunday night football—but was refused.[127] Rather, these programmers entered into exclusive distribution contracts with the incumbent cable system. The plaintiff alleged, *inter alia*, that these agreements were an illegal restraint of trade in violation of section 1 and illegal monopolization under section 2.[128]

121 *Id.* (emphasis supplied and citations omitted).
122 964 F.2d 1022 (10th Cir.), *cert. denied*, 113 S. Ct. 601 (1992).
123 *Id.* at 1027-28.
124 *Id.*
125 826 F. Supp. 1338 (M.D. Ala.), *vacated*, 866 F. Supp. 1376 (M.D. Ala. 1993). The case was vacated pursuant to a settlement following denial of a motion to dismiss, and accordingly, its precedential value is limited. However, *Storer* nonetheless provides a useful juxtaposition to *Futurevision*, 789 F. Supp. 760, and *Turner*, 964 F.2d 1022.
126 *Id.* at 1345.
127 *Id.* at 1346.
128 *Id.* at 1344.

As in *Futurevision*, the court, in denying the motion to dismiss, held that in order to determine whether a vertical restraint is unreasonable under section 1, it is necessary to analyze "the effect of the intrabrand restraints on consumer welfare, in light of the interbrand market structure, and then look to any possible pro-competitive effects on interbrand competition."[129] According to the court, in the cable industry, interbrand competition would include competition among program suppliers, while intrabrand competition would occur among cable television operators.[130]

Next, the court defined the relevant market for interbrand competition. Contrary to *Futurevision* and *Turner*, however, the court held that the market could be defined as narrowly as the "markets for Sunday night NFL games, telecast exclusively on ESPN" or on TNT.[131] The court reasoned that under the Supreme Court's recent holding in *Eastman Kodak Co. v. Image Technical Services, Inc.*,[132] a company's own product can constitute a separate market if there are no substitutes. Thus, the court concluded that because there are no available substitutes for Sunday night NFL football, and this service was "demanded or desired by a substantial number of current and potential cable subscribers,"[133] TNT and ESPN "would possess sufficient market power to foreclose market alternatives."[134]

Turning to the overbuilder's monopolization claim, the court found that under the facts alleged in the complaint, it was "entirely plausible" to infer that the incumbent cable system entered into the contracts with the specific intent necessary to maintain its monopoly over the distribution market for cable television sales.[135] The incumbent had secured its exclusive rights to carry the football package on or about the same time that the overbuilder requested affiliation contracts for this programming.[136] Thus, the court concluded that the incumbent's actions could be seen as part of a willful acquisition or maintenance of its power in violation of

[129] 826 F. Supp. at 1353. (citing Graphic Prod. Distrib., 717 F.2d 1560, 1573 (11th Cir. 1983)).

[130] *Id.* at 1350 n.11.

[131] *Id.* at 1355.

[132] 504 U.S. 451 (1992).

[133] *Storer*, 826 F. Supp. at 1346.

[134] *Id.* at 1355-57. *But cf.* Cable Holdings of G., Inc. v. Home Video, Inc., 825 F.2d 1559, 1563 (11th Cir. 1987) (appropriate product market was "passive visual entertainment, which include[s] cable television, satellite television, video cassette recordings, and free over-the-air television"); *Satellite Television*, 714 F.2d 351.

[135] *Storer*, 826 F. Supp. at 1360.

[136] *Id.*

section 2.[137]

IV. Short-Term Regulation to Improve Long-Term Market Performance

A. *Congressional Response to Industry Performance*

The cases outlined above indicate that a prospective plaintiff will probably have a very difficult time proving that the anticompetitive harms of a vertical restraint sufficiently outweigh the procompetitive benefits to find a violation of the antitrust laws.[138] However, despite the failure of individual plaintiffs to successfully prove that certain vertical restraints in the cable industry violated the antitrust laws under the competitive status quo prior to 1992, virtually all incumbent cable operators continued to enjoy a monopoly in program distribution at the local level.[139]

Therefore, in 1992, concerned about the performance of the market for delivered multichannel video programming,[140] Congress decided to limit those vertical restraints that it believed had helped contribute to the lack of competition in local distribution markets.[141] Congress initially considered banning vertical integration altogether, but found that although such an approach had "appeal," it was too extreme because it would "result in a fundamental restructuring of the cable industry and the way it does business."[142] In the alternative, Congress believed that the better approach was to simply "focus on ensuring competitive dealings between programmers and cable operators and between programmers and competing video distributors."[143] Implicit in this approach is the belief that in order to improve market performance

[137] *Id.*

[138] Perhaps if the plaintiffs had more successfully focused the courts' attention on the nexus between the incumbent's market power and the use of vertical restraints to maintain that power (like the plaintiff in *Storer*, 826 F. Supp. at 1338), their claims of illegal monopolization might have fared better. While this specific case seems not to have been litigated on the merits to date, prospective plaintiffs still would have to overcome the defenses that (1) the programming is capable of duplication and/or substitution, and/or (2) there are efficiencies (i.e., a legitimate business justification).

[139] Cable Act of 1992 § 2(a)(4), 47 U.S.C. § 521 (a)(4) (Supp. V 1993); House Report, *supra* note 2, at 42.

[140] *See* House Report, *supra* note 2, at 26.

[141] From a public policy perspective, not every restraint is necessarily an impediment to entry that requires some type of government intervention. Indeed, before government should impose a regulation on a market, policy makers should perform a cost-benefit analysis that identifies all possible economic efficiencies, if any, that may result from the barrier; all offsetting economic inefficiencies that exceed the value of the efficiencies; all negative and positive externalities; and the economic cost of eliminating the barrier or minimizing its effects. *See* 1994 Competition Report, *supra* note 19, at app. H ¶ 31.

[142] Senate Report, *supra* note 19, at 27.

[143] *Id.*

at the distribution level, entry should be vigorously promoted by eliminating vertical restraints to facilitate non-discriminatory access to cable programming[144]—even at the possible sacrifice of possible static economic efficiencies created by those vertical restraints.

Conceptually, static economic efficiency refers to an "optimal" allocation of scarce resources, such that the processes of production and the consumption of goods and services by consumers cannot be reorganized in any way to increase the economic welfare of one or more individuals without simultaneously decreasing the economic welfare of some other individual. Static efficiency assumes that the quantity of factor inputs is fixed and the state of technical knowledge is given and unchanging.[145] In contrast, "dynamic economic efficiency describes the optimality of the allocation of resources as both the quantity of factor inputs and the state of technological knowledge varies."[146] Put another way:

> The essential difference between static and dynamic efficiency is that whereas the former is the result of making choices along a production-possibilities frontier, the latter is the result of extending the frontier by exploiting as fully as possible a technological potential.[147]

However, the realization of static economic efficiency may conflict with the attainment of dynamic economic efficiency; thus, it is realistic to expect that the attainment of dynamic economic efficiency may require the sacrifice of some static economic efficiencies.[148] Accordingly, Bolter, et al., argued that:

> Where static and dynamic economic efficiency conflict as public policy goals, policy makers should assess the *potential* for technological change in the industry subject to their jurisdiction. An industry that manifests potential for rapid technological change

[144] *See also* HOUSE REPORT, *supra* note 2, at 27 ("A principal goal . . . is to encourage competition from alternative and new technologies, including competing cable system[s], wireless cable, direct broadcast satellites, and satellite master antenna television services.").

[145] Such an economically efficient allocation of resources is also sometimes referred to as "Pareto-optimal" or "Pareto-efficient". *See* JAMES M. HENDERON & RICHARD E. QUANDT, MICROECONOMICS THEORY: A MATHEMATICAL APPROACH 286 (3d ed. 1986).

[146] WALTER G. BOLTER ET AL., TELECOMMUNICATIONS POLICY FOR THE 1980'S: THE TRANSITION TO COMPETITION 359 (Prentice Hall 1984).

[147] BURTON H. KLEIN, DYNAMIC ECONOMICS 35 (Harvard Univ. Press 1977).

[148] *See* JOSEPH A. SCHUMPETER, CAPITALISM, SOCIALISM AND DEMOCRACY 83 (Unwin Paperbacks 1987) (1943). Schumpeter explains:

> A system—any system, economic or other—that at *every* given point of time fully utilizes its possibilities to the best advantage may yet in the long run be inferior to a system that does so at *no* given point of time, because the latter's failure to do so may be a condition for the level or speed of long-run performance.

Id. (emphasis in original).

> and innovation should not be guided by policies focused too narrowly on promoting the best use of society's resources from the standpoint of *today's* technology and resources availability, *i.e.*, static economic efficiency. Rather, an industry with significant potential for rapid technological advance should not be constrained by regulatory or legislative policies that place too little weight on the importance of dynamic economic efficiency. The telecommunications industry in nearly all market segments is presently and prospectively characterized by rapid technological change. Policy makers, therefore, should carefully assess policy choices such that dynamic economic efficiency is given substantial priority in the decision making process.[149]

Such a concept is not new to the Commission. Courts have long-recognized that the FCC is endowed with broad and flexible powers in order to determine the optimal manner in which to regulate a dynamic industry.[150]

B. *The Program Access Policy: the 1992 Cable Act*

Under the 1992 Cable Act's program access provisions, it is 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 deceptive acts or practices, the purpose or effect of which is to hinder significantly or to prevent any [MVPD] from providing satellite cable programming or satellite broadcast programming to subscribers or consumers.[151]

To implement this policy, Congress required the Commission to promulgate regulations, which had to include the following minimum requirements:

> (A) [E]stablish effective safeguards to prevent a cable operator which has an attributable interest in a satellite cable programming vendor or a satellite broadcast programming

[149] WALTER G. BOLTER ET AL., *supra* note 146, at 360 (emphasis in original).

[150] *See, e.g.*, P & R Temmer v. FCC, 743 F.2d 918, 932 n.12 (D.C. Cir. 1984) (Bork, J.); United States v. Storer Broadcasting Co., 351 U.S. 192, 203 (1956); National Broadcasting Co. v. United States, 319 U.S. 190, 219 (1943); FCC v. Pottsville Broadcasting Co., 309 U.S. 134, 138 (1940).

[151] 47 U.S.C. § 548(b) (Supp. V 1993). In addition, Congress also passed program carriage requirements, 47 U.S.C. § 534 (Supp. V 1993), and ordered the Commission to conduct a proceeding to: (a) prescribe rules regarding the number of channels on a cable system that can be occupied by programming in which the cable operator has an attributable interest (channel occupancy rules), and (b) to consider the necessity and appropriateness of imposing limitations on the degree to which MVPDs may engage in the creation or production of video programming. *See* 47 U.S.C. § 533(f) (Supp. V 1993).

vendor from unduly or improperly influencing the decision of such vendor to sell, or the prices, terms, and conditions of sale of, satellite cable programming or satellite broadcast programming to any unaffiliated [MVPD];[152]

(B) [P]rohibit discrimination by a satellite cable programming vendor in which a cable operator has an attributable interest or by a satellite broadcast programming vendor in the prices, terms, and conditions of sale or delivery of . . . programming among or between cable systems, cable operators, or other [MVPDs];[153]

(C) [P]rohibit practices, understandings, arrangements, and activities, including exclusive contracts for satellite cable programming or satellite broadcast programming between a cable operator and a satellite cable programming vendor or satellite broadcast programming vendor, that prevent 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 to persons in areas not served by a cable operator as of . . . 1992;[154] and

(D) [W]ith respect to distribution to persons in areas served by a cable operator, prohibit exclusive contracts for satellite cable programming or satellite broadcast programming between a cable operator and 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, unless the Commission determines . . . that such contract is in the public interest.[155]

In order to determine whether an exclusive contract is in the public interest, the Commission must consider the following five factors with respect to the effect of the contract on the distribution of video programming services served by a cable vendor:

(A) [T]he effect of such exclusive contract on the development of competition in local and national multichannel video programming distribution markets;

(B) [T]he effect of such exclusive contract on competition from multichannel video programming distribution technologies other than cable;

(C) [T]he effect of such exclusive contract on the attraction of

152 47 U.S.C. § 548(c)(2)(A) (Supp. V 1993).
153 47 U.S.C. § 548(c)(2)(B) (Supp. V 1993).
154 47 U.S.C. § 548(c)(2)(C) (Supp. V 1993).
155 47 U.S.C. § 548(c)(2)(D) (Supp. V 1993).

capital investment in the production and distribution of new satellite cable programming;

(D) [T]he effect of the exclusive contract on diversity of programming in the multichannel video programming distribution market; and

(E) [T]he duration of the exclusive contract.[156]

The legislative history makes clear that Congress neither intended to make exclusive contracts per se illegal nor to "equate exclusivity with an unreasonable refusal to deal."[157] Rather, the legislative history shows a congressional concern that while "exclusivity can be a legitimate business [justification] where there is effective competition. Where there is no effective competition . . . exclusive [contracts] may tend to establish a barrier to entry and inhibit the development of competition in the market."[158] In light of this legislative intent, the 1992 Act therefore asks the Commission to balance the efficiency-enhancing characteristics of vertical contracts, often favored in litigation, with the elimination of economic harms described above. Indeed, the Commission has both granted and denied petitions for exclusivity depending on the specific facts of each case.[159]

From a legal perspective, the 1992 Act appears to shift the burden of proof away from the party seeking programming and onto the party seeking exclusivity. That is to say, under the 1992 Act, exclusive contracts are disfavored, and cable operators have the burden to show that they serve the public interest. Although such a procedural approach is different from that found under the antitrust laws, the analytical approach of balancing procompetitive benefits against anticompetitive harms appears to be much the same.

Finally, the program access policy is only intended to be a

156 47 U.S.C. § 548(c)(4) (Supp. V 1993). In the 1994 Competition Report, the Commission received several comments regarding the applicability of the program access policy solely to (a) vertically-integrated vendors, and (b) programming delivered by satellite. *See* 1994 Competition Report, *supra* note 19, ¶¶ 179-182. As to the first point, recent economic literature suggests that from an economic point of view, both integrated and non-integrated firms tend to engage in the same pattern of behavior with respect to program pricing and availability; that is, some cable operators accomplish by vertical integration what others do by exclusive contracts with non-cable owned programmers. *See* Waterman & Weiss, *supra* note 9, at 89. As for the second point, because of recent and continuing rapid technological developments in multichannel video distribution technology, including the deployment of fiber optic trunk cable, questions arise whether the program access policy should focus on the method of distribution. *See infra* section IV.C.
157 SENATE REPORT, *supra* note 19, at 28.
158 SENATE REPORT, *supra* note 19, at 28.
159 *See, e.g.*, 1994 Competition Report, *supra* note 19, at app. F (listing all program access cases resolved as of September 19, 1994).

short-term measure. The program access provisions of the 1992 Act terminate in the year 2002 (ten years from the Act's enactment), unless the Commission finds that "such prohibition continues to be necessary to preserve and protect competition and diversity in the distribution of video programming."[160]

C. *The Advantage of a Regulatory Approach Versus an Antitrust Remedy*

As Justice Stephen Breyer once noted, while public regulation and the federal antitrust laws "typically aim at similar goals—*i.e.*, low and economically efficient prices, innovation, and efficient production methods," economic regulation seeks to achieve these goals directly "though rules and regulations; [however,] antitrust seeks to achieve them indirectly by promoting and preserving a process that tends to bring them about."[161] If a goal of national telecommunications policy is to quickly and effectively improve the long-term performance of the market for delivered multichannel video programming, short-term regulation appears to be a more effective mechanism than relief under the antitrust laws.

Specifically, a narrowly-tailored regulatory approach is perhaps the best way to keep pace with the dynamic nature of the telecommunications industry. Indeed, several economists have argued that a "major lesson" of the history of federal telecommunications regulation is "the importance of adapting the regulatory environment to major, economic, technological, and political changes . . . ."[162] That is to say, "*regulatory innovation* should accompany the ongoing structural change of the telecommunications industry."[163]

Indeed, under the particular circumstances found in the distribution market for delivered multichannel video programming, a short-term regulatory remedy is less costly, far faster, and more effective than if prospective plaintiffs sought similar relief under the antitrust laws.[164] By adjudicating these claims before a single, expert agency—as opposed to through cases arising in a variety of jurisdictions—it is possible to achieve a consistent program access policy, and thus improve overall market performance. Moreover, because responsible telecommunications policy must be able to quickly and adequately respond to industry structure, conduct, and performance, an administrative agency with industry expertise is better equipped to analyze and react to such changes than would be a series of courts.

The program access policy embodies this idea. This policy is specifically intended to improve long-term market performance through limits on vertical restraints for a period of ten years. In contrast, antitrust litigation is an expensive, time-consuming process with often uncertain results. Even if a plaintiff can successfully prove that a vertical restraint has, in fact, injured competition in the distribution market for delivered multichannel video programming—an achievement that no party apparently has accomplished to date—one case alone cannot significantly enhance overall long-term market performance because other similarly-situated plaintiffs must nonetheless incur substantial litigation costs to prove the merits of their respective cases. Similarly, because each judicial decision is fact-specific, the precedent created—if applied to other situations—may not lead to optimal long-term market performance. In fact, the litigation of one case might last nearly as long as the entire program access policy.[165]

D. *Success of the Program Access Policy*

As stated above, the program access policy is designed to im-

[160] 47 U.S.C. § 548(c)(5) (Supp. V 1993).

[161] *See* Town of Concord v. Boston Edison Co., 915 F.2d 17, 22 (1st Cir. 1990), *cert. denied*, 499 U.S. 931 (1991); *see also* United States v. FCC Satellite Bus. Sys., 652 F.2d 72, 88 (D.C. Cir. 1980) ("Since 'the basic goal of direct governmental regulation through administrative bodies and the goal of indirect governmental regulation in the form of antitrust law is the same—to achieve the most efficient allocation of resources possible,' we have insisted that the agencies consider antitrust policy as an important part of their public interest calculus." (citation omitted) (quoting Northern Natural Gas, Co. v. Federal Power Comm'n, 399 F.2d 953, 959 (D.C. Cir. 1968))); United States v. American Telephone & Telegraph Co., 498 F. Supp. 353, 364 (D.D.C. 1980) ("[I]t is not appropriate to distinguish between Communications Act standards and antitrust standards on the basis that the former are in the 'broad public interest' area while the latter serve the interests of 'competition.' Although technically the Communications Act focuses on public necessity and convenience and the Sherman Act on competition, in a very real sense both the FCC, in its enforcement of the Communications Act, and the courts, in their application of the antitrust laws, guard against unfair competition and attempt to protect the public interest.").

[162] *See* WALTER G. BOLTER ET AL., *supra* note 146, at 25 (emphasis in original).

[163] *Id.*

[164] *See* 47 C.F.R. § 76.1000-.1002 (1994).

[165] *See Cable TV Consumer Protection Act of 1991: Hearings Before the Subcomm. on Communications of the Committee on Commerce, Science and Transportation on S. 12*, 102d Cong., 1st Sess. 306 (1991) (statement of Robert L. Schmidt, President, Wireless Cable Ass'n):

> The important question to ask is: if existing antitrust laws are adequate to attack anti-competitive behavior, then why do we need legislation? The answer is, that, if, as a matter of public policy, you agree that there should be competition and consumer choice in the marketplace across the country, if you agree that there is a need for the different forms of distribution to be successful and get out there in the market, then it is not a very satisfactory solution to expect individual, entrepreneurial, start-up companies, who are relatively less well funded, to take on some of the country's largest companies on a case-by-case, market-by-market basis in antitrust litigation. That's why, although legal remedies are available, they are not really completely satisfactory from an industry perspective, or indeed from a public policy perspective.

prove the performance of the distribution market by removing impediments to entry for rival distribution technologies created by vertical restraints—even at the expense of possible static economic efficiencies created by those restraints. In the 1994 Competition Report, the Commission found that the Act's program access policy has, in fact, made a significant difference for promoting competition for delivered multichannel video programming in the distribution market. Specifically, the Commission "found that following the implementation of the program access provisions of the 1992 [Cable] Act, the cable industry's use of program availability as a means of deterring entry has, to a large extent, abated."[166]

For example, immediately following the enactment of the 1992 Act, wireless cable operators were able to raise about six hundred million dollars from the public financial markets, thus enabling these firms to acquire multiple systems and lay the foundation for the economies of scale currently enjoyed by cable MSOs.[167] Indeed, in a recent investment recommendation letter, one Wall Street firm stated that but for the program access provisions contained in the 1992 Act, the "wireless cable business would have remained in ashes."[168] Similarly, non-discriminatory access to programming has also been credited with much of DBS's success.[169]

Moreover, it is not clear that the program access policy has resulted in a sacrifice of static economic efficiencies. As stated above, the number of new programming networks has continued to enjoy strong growth. There is even some evidence of new programming tailored specifically for alternative distribution media.[170] For example, DBS has the All News Channel, a joint venture between Viacom Broadcasting, Inc. and Hubbard Broadcasting, Inc.,

166 1994 Competition Report, *supra* note 19, ¶ 231.

167 *Id.* ¶ 80 (footnote omitted).

168 *The Wireless Cable Industry*, DILLON READ EQUITY RESEARCH, Aug. 22, 1994, at 3.

169 *See* Dick Strasbaugh, *Washington Footprint*, SATELLITE BUS. NEWS, Jan. 18, 1995, at 4; NCTA, *Legislative Issues in Focus: Effective Competition to Cable* (Jan. 1995) (DBS and other rival distribution technologies "are aided by the program access provisions of the 1992 Cable Act, which have firmly established the ability of alternative [MVPDs] to compete in the market for cable tv."); Eric Schine, *Digital TV: Advantage, Hughes*, BUSINESS WEEK, Mar. 13, 1995, at 66, 67 (James Ramo, DirecTV's marketing head, stated, "without [program access,] we would have been dead.").

170 *See supra* note 16 and accompanying text. While recent industry publications have reported that the increasing number of potential cable programmers can be attributed to the increased channel capacity on existing systems facilitated by digitalization, *id.*, the increase in programmers may also be linked to the sheer increase in the number of new and viable alternative distribution providers. *See HBO's Fuchs Blasts Ops at Critics Tour*, MULTICHANNEL NEWS, Jan. 23, 1995, at 14 (According to Home Box Office Chairman Michael Fuchs, "cable operators will be in danger of 'losing the pay television franchise' to DBS services because of DBS's superior marketing muscle and channel capacity.").

and some wireless operators, though capacity constrained, are differentiating their programming offerings by providing interactive services or a foreign language subscription service.[171] Thus, although the program access policy is still in its early stages, there is some evidence that by accelerating the de-concentration of the distribution market, the program access policy may, in fact, be improving the performance of *both* the distribution and programming market.

From a procedural perspective, the program access policy has also met with success. From November 1993, when the program access regulations took effect, through June 30, 1994, only twelve program access cases were filed; eleven have since been resolved.[172] Considering the overloaded dockets of many federal district courts in America, the procompetitive effect on market performance by the expeditious and analytically consistent resolution of so many cases in so short a time cannot be discounted.

Moreover, an analysis of these decisions reveals that the Commission has, in fact, engaged in the type of balancing analysis prescribed by the 1992 Act and recent economic literature. For example, in *Time Warner Cable*,[173] the Commission found that continued enforcement of Time Warner's exclusive contract with Court TV was not in the public interest, because the need for exclusivity (the network had over thirteen million national subscribers)[174] did not outweigh the potential anticompetitive harms, including the effect on a rival distributor's ability to compete in the Manhattan market without the service.[175] In contrast, the Commission found that New England Cable News ("NECN"), a regional news programming source that is fifty-percent owned by Continental Cablevision, had shown that exclusivity was critical to attract investment and secure distribution, which was essential to its financial viability.[176] NECN also showed that exclusive distribution would foster diversity.[177] The Commission also found that exclusivity would not have an adverse effect on the development of compe-

171 *See The 'Sacred Bond' is Out*, CABLEVISION, Oct. 24, 1994, at 61.

172 *See* 1994 Competition Report, *supra* note 19, ¶ 174.

173 *See In re* Time Warner Cable Petition for Public Interest Determination Relating to Exclusive Dist. of Courtroom Television, 9 F.C.C.R. ¶ 26, at 3225 (1994).

174 *Id.* ¶¶ 43-53.

175 *See id.* ¶ 37.

176 New Eng. Cable News, Petition for Public Interest Determination Under 47 C.F.R. § 76.1002(c)(4) Relating to Exclusive Dist. of New Eng. Cable News, Memorandum Opinion and Order, *In re* New England Cable News, 9 F.C.C.R. ¶¶ 34-39, at 3236 (1994) [hereinafter NECN Exclusivity Order]. The evidence indicated that NECN had about 900,000 subscribers in a potential market of approximately three million.

177 *Id.* ¶¶ 41-43.

tition with the cable systems affiliated with NECN.[178] Therefore, the Commission held that reasonably-tailored exclusivity was in the public interest and granted NECN's petition with certain limits as to the duration of exclusivity.[179]

Ultimately, if the program access policy successfully results in a rivalrous distribution market, vertically-integrated cable operators may find that the costs of entry-deterring strategies outweigh the benefits received. That is, so long as a vertically-integrated MSO remains as the sole distributor in the distribution market, it can continue to extract monopoly rents in that market. Thus, under such circumstances, the MSO will continue to have the incentive to engage in entry-deterring strategies. On the other hand, if there are several firms in the distribution market, a vertically-integrated incumbent will no longer be able to extract monopoly rents in the distribution market. If it also controls popular programming, the firm may be able to compensate for the loss of revenue (rents) at the distribution level by actively marketing its programming to other distributors. Under such a circumstance, if the firm nonetheless attempted to withhold the programming, it would actually suffer a net detriment because the MSO would lose the profits associated with that sale.[180] Thus, once there is a robust distribution market, vertically-integrated MSOs may conclude, over time that using vertical restraints to foreclose entry will not be to their advantage, because the revenue gained at the input level by producing and selling successful programming to rivals will exceed the costs incurred to deter entry.[181]

V. Conclusion

The program access policy is designed to provide a short-term mechanism to improve the long-term market performance of the distribution market for delivered multichannel video programming. It seeks to achieve this goal by attempting to accelerate the

[178] *Id.* ¶¶ 29-32.

[179] Under the terms of the Commission's order, NECN is allowed to offer exclusive distribution rights to cable affiliates for a period of 18 months, but all such exclusive distribution rights must terminate seven years from the effective date of the Commission's order granting NECN's petition. *NECN Exclusivity Order*, *supra* note 176, ¶¶ 49-51, 53.

[180] *See* Wildman & Owen, *supra* note 5, at 246.

[181] *See, e.g.*, *Redstone Says Viacom's Bowing Out of Cable Because Distribution Won't Pay*, Cable-Telco Report, Vol. 5, No. 21 (Oct. 24, 1994); Jim Cooper, *Redstone Sees Software as Key to Superhighway*, Broadcasting & Cable, Feb. 14, 1994, at 11; Paul Farhi, *Master of the Megadeal: Summer Redstone Builds a Popculture Empire—And isn't Waiting for a Data Highway*, Wash. Post, Oct. 30, 1994, at H1 ("Redstone's vision is the notion that the means of distribution is less important than what is distributed to consumers"). However, if competition is not sufficiently robust, a vertically-integrated firm may conclude that the benefits gained from foreclosing entry will exceed the revenues foregone by lost sales.

de-concentration of the distribution market by ensuring non-discriminatory access to cable programming—even at the possible expense of potential static economic efficiencies. Given the rapidly evolving nature of the MVPD industry, it is an intelligent use of public policy to focus on dynamic rather than static economic efficiencies to promote long-term consumer welfare. As market performance, which is the most pragmatic test of a policy's effectiveness, indicates that American consumers are beginning to have the option to choose from more than one provider of delivered multichannel video programming it therefore appears that program access has been an effective public policy to date.