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May 23, 2002

Mr. Charles A. James
Assistant Attorney General
Antitrust Division
United States Department of Justice
10th Street & Pennsylvania Ave.
Washington, DC 20530

Re: Request for Business Review Letter
The National Cable Television Cooperative, Inc.

Dear Mr. James:

On behalf of our client The National Cable Television Cooperative, Inc. ("NCTC"), we hereby request a business review letter pursuant to the Department of Justice's business review procedure set forth in 28 C.F.R. § 50.6 (2001).[1]

NCTC is a Kansas nonprofit corporation. NCTC's members (each, a "Member" and together, the "Members") are approximately 993 cable television system owners and operators that own or operate 6,999 cable television systems ranging in size from small systems serving less than 100 subscribers to larger systems with up to 190,000 subscribers. NCTC's Members serve approximately 14.4 million total cable television subscribers - about 16.5% of the total video subscriber households in the United States.[2] The Members include cable television system owners and operators from across the nation in all 50 states. The average size of each NCTC Member system is approximately 2,000 subscribers. However, the median size is just over 350 subscribers. There are 4,400 member systems that serve fewer than 1,000 customers.

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[1] The formation of NCTC (then Mid-America National Cable Television Cooperative, Inc.) was the subject of a business review letter issued April 25, 1985.

[2] Based on the reported subscriber distribution of widely distributed programming like CNN, TBS, or ESPN of about 85 million subscribers. This total includes both cable television and direct broadcast satellite ("DBS") subscribers. (Kagan Cable Program Investor dated December 27, 2001).

There is very little competition among the Members of NCTC. Of the 6,999 cable television systems operated by NCTC Members, only 61 communities, less than one percent of this total, are served by multiple Members. In many of these cases, the Members who report subscribers in these communities probably do not actually compete for the same homes. [3]

The primary purpose of NCTC has been to achieve buying efficiencies in connection with the Members' purchases of cable programming ("Programming") from various programming providers such as Disney, CNN, and ESPN (each, a "Programmer" and collectively, the "Programmers"), to the end that the Members might enjoy the more favorable purchase terms that the Programmers make available to the large multiple system cable operators ("MSOs"). These large MSOs are able to guarantee distribution of the Programming to a large subscriber base. Other benefits afforded to NCTC Members include reduced administrative and legal expense in the negotiation and management of programming agreements and consolidated billing and reporting.

Under NCTC's current operating procedure, NCTC signs Master Programming Agreements (each, a "Master Agreement" and collectively, the "Master Agreements") with various Programmers without commitments from any Member to actually participate under the Master Agreement. The Master Agreement is then made available to any Members that choose to offer the Programming under the terms of the Master Agreement. Members are free to purchase desired programming pursuant to a NCTC Master Agreement or pursuant to an agreement separately negotiated and executed between the Member and the Programmer. NCTC does not have Master Agreements for all programming (e.g., there are no NCTC Master Agreement for USA, The National Network (formerly Nashville Network), Country Music Television, and others) and Members must independently negotiate for that programming. Furthermore, in some cases even where programming is available through NCTC, Members may elect to negotiate their own agreements directly with the Programmer.

In many cases, especially in the case of renewal contracts, NCTC's current approach to negotiating agreements with Programmers makes it difficult for NCTC to obtain favorable terms. Unlike large MSOs and direct broadcast satellite ("DBS") providers, NCTC is unable to guarantee a Programmer a minimum number of subscribers if the Programmer agrees to favorable terms. Moreover, NCTC is unable to take a "bottom line" position above which the Members it represents would supply their subscribers with alternative programming rather than accept unfavorable contract terms.

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[3] In some cases involving very large communities (e.g. the 3 members reporting subscribers in Los Angeles) the systems probably serve few if any of the same homes. In other cases involving comparatively small communities, (e.g. the 2 members reporting subscribers in Thorntown, Indiana) it is more likely that the Members' systems actually pass some of the same homes.

NCTC is considering an alternative buying strategy that would enable it to negotiate Master Agreements more efficiently for the benefit of its Members and to obtain more favorable terms for the Members desiring to carry Programming - thus reducing Members' costs and making them more competitive. It is this proposed strategy that is the subject of this business review letter request. To assist your evaluation of the proposed structure, an overview of the industry, an explanation of the proposed strategy and an analysis of the relevant antitrust issues are set forth below.

I. INDUSTRY BACKGROUND

The competitive environment facing NCTC and its Members is one in which many Programmers are owned by large media conglomerates, such as Disney, NBC, AOL Time Warner, Viacom, and Fox. Much of the Programming has developed extremely strong subscriber loyalty. This allows the Programmer to impose substantial rate increases since they are confident that the cable system operator will not discontinue carriage of the programming due to anticipated customer resistance and subscriber loss (particularly with the availability of DBS service carrying that Programming). This has particularly been the case with sports programming vendors (*e.g.*, ESPN) that have been able to impose annual increases of 20% to 100%. Cable owners and operators (especially smaller operators) are facing strong competition from DBS providers (i.e. DirectTV and Echostar) that also enjoy substantial bargaining power in negotiations with Programmers due to their ever-increasing size.

At the same time, a few MSOs have grown to substantial sizes, largely as a result of continued consolidation in the industry. Time Warner served 12.7 million subscribers as of September, 2001. ATT Broadband served 23.6 million subscribers as of December 31, 2000 [4]and now intends to merge about 16 million of those subscribers with Comcast, which served 8.4 million subscribers as of September 2001. DBS providers have also become very large. As of December 31, 2001 EchoStar (Dish Network) served more than 7 million subscribers and Direct TV served 10.5 million subscribers. A proposed merger is also pending between Dish Network and Direct TV. These large MSOs and DBS providers have substantial resources to allow them to invest in programming networks, launch alternative programming and secure "exclusive" programming distribution rights. These large MSOs and DBS providers are clearly in a position to negotiate lucrative and favorable programming agreement terms. ATT and Comcast have reported that as a result of the proposed merger they anticipate saving $250 million - $400 million in programming costs annually.

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[4] As of December 31, 2000 ATT Broadband served 23.6 million subscribers, including 16 million in managed systems and 7.6 million in non-managed subsidiaries. (ATT Form 10-K filed with the SEC on April 17, 2001).

Based on industry experience and consistent refusal of programmers to offer "most favored nations"[5] protection, NCTC believes that its rates remain well above the rates offered to larger MSOs and DBS providers. In fact, NCTC rates in some cases appear to be higher than those of operators similar or even smaller in size than NCTC.

II. PROPOSED STRATEGY

Under NCTC's proposed strategy all or some portion of the Members desiring to obtain Programming through NCTC would be requested to sign a written agreement (a "Commitment Agreement") with NCTC that would provide, with respect to the particular Programming involved, (a) the terms (the "Preferred Terms") under which the Member would agree to carry Programming under the Master Agreement, which terms would likely include the price the Member would pay the Programmer for the Programming and the term of the Master Agreement; (b) that if NCTC were to enter into a Master Agreement having terms at least as favorable as the Preferred Terms, the Member would be obligated to launch (or continue to carry in the case of a renewal) the specified Programming under the Master Agreement; (c) that if NCTC were unable to negotiate a Master Agreement having these terms, the Member would be permitted to negotiate and execute its own agreement with the Programmer on the same or better terms (for the operator); and (d) if NCTC were unable to negotiate a Master Agreement having these terms and if the Member were unable to reach such an equivalent or more favorable agreement with the Programmer, the Member would not carry the Programming for a specified period of time, generally 1- 2 years. Commitment Agreements would relate only to one Master Programming Agreements or possibly to one related set of Master Programming Agreements for related or commonly-owned Programming networks. NCTC Members will not be required to commit to the purchase of any of their programming through Master Agreements negotiated by NCTC. Members who do not wish to purchase particular Programming through an NCTC Master Agreement will continue to be free to purchase that Programming through an agreement that they negotiate separately with the Programmer.

Once a Master Agreement is negotiated with a Programmer, each Member carrying the Programming pursuant to the Master Agreement would do so on generally identical terms. Generally all Members, whether or not they signed a Commitment Agreement, would be eligible to participate under a completed Master Agreement. Those Members that did enter into a Commitment Agreement with NCTC would be required to honor their commitment. If a Member breaches any of its obligations under the Commitment Agreement, NCTC's remedy would be limited to the termination of that Member's membership in NCTC.

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[5] "Most favored nations" or "MFN" provisions would assure an operator that it is acquiring the programming on terms no less favorable than the terms offered other comparable operators.

III. THE PROPOSED STRATEGY WILL HAVE SAFEGUARDS IN PLACE

NCTC's proposed strategy will incorporate the following "safeguards":

(1) An employee of NCTC who is not affiliated with any Member will manage the negotiation of the Master Agreement with the Programmers and the terms of the Commitment Agreement with NCTC Members;

(2) Members will be prohibited contractually from sharing or disseminating (except to their lawyers, accountants and other professional advisors) competitively sensitive information, such as Member-specific costs and pricing, and NCTC will only share with the Members the names of those Members that have agreed to enter into a Commitment Agreement for specific Programming;

(3) NCTC would not accept Commitment Agreements from Members known by NCTC to be competitors;[6]

(4) NCTC would not use Commitment Agreements to negotiate Programming Agreements for Programming if the total number of NCTC Members' subscribers for that Programming exceeds 20% of the total industry distribution of that Programming; and

(5) NCTC will not use Commitment Agreements in negotiating so many Master Agreements that the annual cost of programming under those agreements would represent more than 20% of the Members' annual revenue.[7]

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[6] NCTC does not maintain records that enable it to determine whether Members actually serve the same homes. NCTC's records do indicate, however, that multiple members report having subscribers in some of the same communities. In some cases (e.g. the 3 members reporting subscribers in Los Angeles) the systems probably do not serve the same homes. In other cases (e.g. the 2 members reporting subscribers in Thorntown, Indiana) it is more likely that the Members actually compete for the same homes. Of the 6,999 cable television systems operated by NCTC Members only 61 communities are served by multiple members. Thus although some competition among NCTC Members may occur, it is not material. To avoid any issue, however, NCTC will not accept Commitment Agreements for specified Programming from Members shown by NCTC's records to be serving the same community.

[7] Industry statistics report that programming represents approximately 22% of total subscriber revenue, based on estimated total cable revenue of $40.855 billion in 2000 with total programming expenditures of $8.882 billing for the same year. (See Kagan World Media, Broadband Financial Databook 2001; Testimony of Robert Sachs, President of NCTA before the Senate Judiciary Committee's Subcommittee on Antitrust, Business Rights, and Competition on April 4, 2001). Since some leading programming is not available from NCTC (e.g. USA, Nashville Network, Country Music Television, and others) it is unlikely that even if a Member purchased all of the available NCTC programming those programming costs would exceed the 20% of revenue threshold. To avoid any issue in this regard, however, NCTC would limit the frequency of use of Commitment Agreements to avoid any reasonable likelihood that the threshold would be exceeded.

These measures, in addition to those mentioned previously, should sufficiently safeguard against any potential for improper information exchange, the exercise of monopsony power, or coordinated pricing decisions under the antitrust laws.

IV. THE PROPOSED STRATEGY FALLS WITHIN THE APPLICABLE SAFE HARBOR PROVISIONS

The Department of Justice and Federal Trade Commission Statement of Antitrust Enforcement Policy on Joint Purchasing Arrangements Among Health Care Providers (the "Guidelines") sets forth the legal framework for analyzing the antitrust implications of joint purchasing arrangements. Although initially drafted for the health care industry, the Division has applied the Guidelines to proposed joint buying arrangements across all industries.[8] The Guidelines, in the first instance, articulate the procompetitive potential of a joint purchasing group: "the participants frequently can obtain volume discounts, reduce transaction costs, and have access to consulting advice that may not be available to each participant on its own." Guidelines Introduction. "Where there appear to be significant efficiencies from a joint purchasing arrangement, the Agencies will not challenge the arrangement absent substantial risk of anticompetitive effects." Id. at Part B.

Under these principles, the Guidelines state that "[j]oint purchasing arrangements are unlikely to raise antitrust concerns unless (1) the arrangement accounts for so large a portion of the purchases of a product or service that it can effectively exercise market power in the purchase of the product or service, or (2) the products or services being purchased jointly account for so large a proportion of the total cost of the service being sold by the participants that the joint purchasing arrangement may facilitate price fixing or otherwise reduce competition." Id. at Introduction. "If neither factor is present, the joint purchasing arrangement will not present competitive concerns." Id.

Within this framework, the Guidelines establish an "antitrust safety zone." Absent extraordinary circumstances, the agencies will not challenge a joint buying arrangement so long as: "(1) the purchases account for less than 35 percent of the total sales of the purchased product or service in the relevant market; and (2) the cost of the products and services purchased jointly accounts for less than 20 percent of the total revenues from all products or services sold by each competing participant in the joint purchasing arrangement." Id. at Part A.

In addition, the recently adopted Department of Justice and Federal Trade Commission Antitrust Guidelines for Collaborations Among Competitors (the "JV

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[8] See, Business Review Letter re: Joint Purchasing Association for Funeral Homes (Jan. 13, 1999); Business Review Letter re: California Large Electric Power Purchasing Ass'n (Nov. 20, 1997); Business Review Letter re: Utilities Service Alliance (July 3, 1996); Business Review Letter re: Texas Oil Drilling Proposal to Form Joint Purchasing Agent to Procure Chinese Barite (May 13, 1996); Business Review Letter re: BTCC Proposal to Form Group to Negotiate Domestic Air Travel Fares (July 14, 1995).

Guidelines") generally permit an arrangement if the combined market share of the members and the venture do not exceed 20% of the affected market.

The new strategy proposed by NCTC fails well within these safe harbors. Depending upon the specific programming involved and the level of participation by the NCTC membership, the percentage of total network subscribers to be included under a Master Agreement would vary from less than 1% to no more than 16.8% of the total number of the Programmer's subscribers. Even assuming the maximum level of participation, whereby all of NCTC's current members would choose to participate in a particular Master Agreement, the transaction still would fall substantially below the thirty-five percent (35%) threshold that delimits the boundaries of the antitrust safety zone under the Guidelines.

Such a transaction would fall well within the general 20% safety zone articulated under the new JV Guidelines. [9] In fact, although such a measure largely is unnecessary in light of the size of NCTC's current Membership, NCTC's proposal includes safeguards to assure that Commitment Agreements never will be used to negotiate carriage of any programming for which NCTC Members' subscribers would constitute more than 20% of the applicable network's total subscribers.

As explained above, NCTC's proposal also incorporates a safeguard to ensure that in the aggregate, the programming costs paid under Master Agreements negotiated using Commitment Agreements will never exceed 20% of its Members' total revenue. This limitation also is largely superfluous given the lack of any significant competition among NCTC's Members. Nonetheless, it will ensure compliance with the second prong of the safety zone test under the Guidelines, and allay any theoretical concerns that the arrangement could otherwise facilitate coordinated pricing decisions in those rare situations in which two Members might serve the same geographic area.

V. CONCLUSION

In summary, the strategy proposed by NCTC is well within the "safe harbors" established by the Division for joint buying groups and joint ventures. With the safeguards described above, there is no risk of monopsony purchasing power or risk that the arrangement could facilitate price fixing or otherwise reduce competition. The proposed strategy will simply allow NCTC to be in a better position to offer its independent, smaller cable owners and operator Members better Programming terms, thus placing them in closer parity with larger MSOs and satellite competitors and

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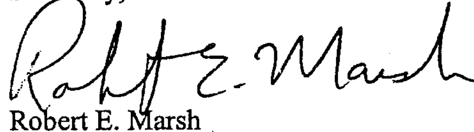
[9] By contrast, programming agreements entered into by the largest MSOs frequently account for more than twenty percent (20%) of the Programmer's total subscribers. As of November, 2001, widely distributed services like TBS, ESPN and CNN were carried in about 85.5 million households. (Kagan Cable Program Investor dated December 27, 2001). Thus ATT's 23.6 million subscribers as of December 31, 2000 represents about 28% of the subscribers receiving this widely distributed programming.

allowing them to negotiate more efficiently and effectively for the purchase of Programming and lower the price of the Programming to their consumers.

We would be pleased to provide you with any further information you deem necessary, or to address any questions or comments you may have regarding this business review request. Thank you in advance for your attention and consideration in this matter.

Sincerely,



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CC: Michael Pandzik
Frank Hughes