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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992 Tier Buy-Through Prohibitions	MM Docket No. 92-262

COMMENTS OF DISCOVERY COMMUNICATION, INC.

A. Introduction

Discovery Communications, Inc. ("Discovery Communications") hereby submits these comments in response to the Notice of Proposed Rule Making (the "Notice") in the above referenced proceeding. In particular, Discovery Communications addresses the questions raised in paragraphs 7 and 8 of the Notice concerning the definition of "discrimination between subscribers."

Discovery Communications is a programmer. It owns The Learning Channel and operates The Discovery Channel. Both channels license their programming to cable operators and other multichannel video programming distributors on a non-discriminatory basis.

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B. The Statutory Provisions at Issue are Unconstitutional.

Discovery Communications has challenged the constitutionality of various provisions of the Cable Television Consumer Protection and Competition Act of 1992 (the "Act"), including the rate provisions that are the subject of this rulemaking proceeding. Discovery Communications, Inc., v. United States of America, C.A. No. 92-2558 (filed November 12, 1992). (A copy of Discovery Communication's complaint was included in prior comments submitted to the Commission in MM Docket No. 92-259.)

Discovery Communication's constitutional challenge is not directed at the specific content of the rate provisions, but at rate regulation as such. As the complaint states, it is unconstitutional to target one kind of first amendment speaker with rate regulation not generally applicable to everyone. See e.g. Riley v. National Federation of the Blind of North Carolina, 487 U.S. 781 (1988). Thus, for example, while Congress properly can pass generally applicable antitrust laws outlawing certain kinds of price discrimination, it cannot without compelling justification impose special restrictions on the first amendment speech of cable operators. Because the Act itself targets cable operators' rates, it necessarily affects their speech -- a constitutional defect which Commission regulations cannot cure.

Discovery Communications submits these comments without waiving its constitutional claims. The possibility that the Commission may adopt regulations does not interdict a facial challenge to the constitutionality of the underlying statute.

Nixon v. Administrator of General Services Administration, 433 U.S. 425, 439 (1977).

C. Definition of Discrimination

1. Introduction and Summary.

The Commission has requested comments concerning, among other things, the definition of discrimination as used in Section 3(b)(8) of the Act. That section, entitled "Buy-Through of Other Tiers Prohibited," provides:

> "A cable operator may not require the subscription to any tier other than the basic service tier required by paragraph (7) as a condition of access to video programming offered on a per channel or per program basis. A cable operator may not discriminate between subscribers to the basic service tier and other subscribers with regard to the rates charged for video programming offered on a per channel or per program basis."

This section reflects a concern not with price discrimination as such, but rather with price discrimination used as a means of evading Congress' prohibition of the tying of channels sold on a per channel basis to the purchase of intermediate tiers of programming. Recognizing that such a tie can be achieved indirectly by price discrimination, Congress included a restriction on price discrimination in the "buy through" provision. The Commission should construe that language in its context, limiting the definition of "discrimination" to price differentials which effectively evade the buy-through provision. As the Commission's Notice states, the buy-through provision and the non-discrimination provision should "work in tandem." Notice, ¶7.

2. Cable Systems Must Be Able To Price Programming Offered On A Per Channel Basis Higher Than Programming Included In A Package.

A programmer cannot survive and sell programming on a per channel basis at the same price as it is sold when part of a package. Programmers depend on advertising and subscriber revenues to cover the costs of programming and operating a channel. Advertising revenues grow as the number of subscribers grow. Most advertisers will not purchase time on a channel until its subscriber base has hit a minimum threshold. Moreover, amounts paid by advertisers for advertising increase as the subscribership increases. For example, a channel like The Discovery Channel with a subscriber base of almost 60 million derives over half its revenues from advertising sales. The Learning Channel with a considerably smaller subscriber base of about 20 million derives about a third of its revenues from advertising sales. Put another way, The Learning Channel's advertising sales revenues are 4% of The Discovery Channel's advertising revenues.

A program service sold on a per channel basis inevitably has many fewer subscribers than a service sold on a packaged basis and therefore has much lower advertising revenues.[1/] In considering whether to purchase time on a packaged channel,

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1/ The most popular premium channel, HBO, has not quite 20 million subscribers; the second most popular, Showtime, has 10 million subscribers compared to The Discovery Channel's, which is only the fifth largest cable service, 59 million subscribers.

advertisers consider all the subscribers purchasing the package in determining whether their thresholds have been met. Programming sold on an a la carte basis does not have a built-in subscriber base and therefore will generate substantially less advertising revenues if it generates any ad revenues. If a programming service sold a per channel basis is to survive, it must therefore increase its subscriber rates to cable systems substantially to offset lost advertising revenues. Obviously, the differences in costs must be passed on to the consumer if cable systems are to survive. Thus, the most popular pay channel, HBO, charges cable operators between $4 and $5 per subscriber, while The Discovery Channel when included in a package charges approximately ten cents per subscriber. Similarly, the attached rate sheet for The Learning Channel shows much higher rates when the channel is purchased on an *a la carte* basis. See Exhibit A.

Programmers will have to contend not only with decreasing or nonexistent advertising revenues, but also with substantially increased costs. Selling programming on *a la carte* basis is much like selling magazines at a newsstand. The consumer must be motivated anew each month to make the purchase, and costly consumer marketing is necessary to ensure that consumers are aware of the channel and its programming. Programmers such as HBO and Showtime that sell their services on a per channel basis spend as much as ten times more than The Discovery Channel on consumer marketing. If The Discovery Channel were sold on an *a* la carte basis, it would have to spend substantially more on consumer marketing than it does now. Program rights costs might also increase. In a cable system of approximately 100,000 subscribers where The Learning Channel currently charges cable operators a rate of 4 cents a subscriber, it would have to charge cable operators in excess of $2.50 if the channel were sold on an a la carte basis to make up for lost advertising revenues and incremental marketing costs.

Regulations mandating the same price for programming when sold on a per channel or per program basis as when sold as part of a package not only would be economically infeasible, but also unworkable. Price discrimination should not be presumed merely because programming sold on an a la carte basis is more expensive than the average price of a program included in a package. The average price is not hte real price. See Exhibit B. Determining the real per channel value to consumers would be difficult and cannot be derived simply by dividing the total price by the number of channels.

3. Commission Regulations Should Encourage Pro-Competitive Discounting.

Cable operators should be encouraged, not discouraged, from passing on the cost savings associated with packaging. Accordingly, the Commission should not define discrimination in a manner which would preclude the discounting of a package which includes programming offered on a per channel basis.

As the Commission recently recognized in its order concerning the bundling of cellular equipment and service, "bundling is an efficient promotional device which reduces barriers to new customers and which can provide new customers with ... service more economically than if it were prohibited." 7 FCC Rcd 4030 (1992). The same is true with respect to packaging of cable and channels. It reduces prices to individual subscribers by achieving economies of scale, generating more subscribers, serving as an efficient marketing mechanism, increasing advertising revenues, and spreading fixed costs over a greater base. Packaging of programming also facilitates the introduction of new and diverse channels, as evidenced by the more than 25 national basic cable services available today as compared to the five or six national premium channels available.

In addition to encouraging cable operators to pass on cost savings associated with packaging, the Commission regulations should be careful not to discourage pro-competitive price discrimination. Economists have recognized that price discrimination can encourage "experimentation in pricing", improve industry performance, and benefit consumers. Scherer and Ross, Industrial Market Structure and Economic Performance, at 499 -500 (3d. ed. 1990). Price discrimination can maximize output because "[e]ach and every buyer pays as much as he is willing to pay for the quantity he wants," and consumers unwilling to pay the full price are not foregone. Greer, Industrial Organization and Policy, 312 (1980); Scherer and Ross, at 495. To be sure, in some limited contexts, price discrimination can harm competition, but as Professors Scherer and Ross conclude, "With such a complex array of consequences, laws regulating the use of price discrimination must be sophisticated and discerning to encourage desirable practices and discourage undesirable ones." Scherer and Ross, at 508. Similarly, the Commission's regulation should be both sophisticated and discerning so as not to harm consumers.

4. The Recommended Definition

The Commission can comply with Congress' concern about buy-throughs without harming consumers by limiting the definition of "discrimination" to price differentials that would have the effect of evading the buy-through provision. Price differences which have a legitimate justification should not be construed as evading the buy-through provision. Legitimate justifications include, but are not limited to, (i) economies of scale, (ii) other differences in cost, (iii) generally available volume discounts, and (iv) differences in marginal utility to the buyer. Moreover, the regulations should provide that a price difference cannot be considered evasive, and therefore improperly discriminatory, when a significant number of subscribers to tiers other than the basic tier are in fact subscribing to the channel or program on an *a la carte* basis.

The Robinson-Patman Act permits cost-justified price differences, volume discounts which are available to all purchasers, and prices differences that do not have the potential to injure competition. 15 U.S.C. § 13(a); *Shreve Equip., Inc. v. Clay Equipment Corp.*, 650 F.2d 101, 105 (6th Cir.), *cert. denied*, 454 U.S. 897 (1981), (a volume discount "functionally available on an equal basis" to all customers would not constitute discrimination.) Similarly, the Cable Act of 1992 should be construed as permitting cost-justified price differences, volume discounts, and price differentials that do not evade the buy-through provision. To the extent that there is a reasonable basis justifying a group discount, the Commission should not prevent cable operators from passing on savings to their customers.

In any event, a definition of price discrimination tailored closely to Congress' limited concern with buy-throughs may be the only practicable approach. As a leading economic treatise notes:

> "No simple, all-inclusive definition of price discrimination is possible. Succinctly, price discrimination is the sale (or purchase) of different units of a good or service at price differentials not directly corresponding to differences in supply cost. Note that this definition includes not only the sale of identical product units to different persons at varying prices, but also the sale of identical units to the same buyer at differing prices (for example, when electric utilities charge less for additional kilowatt hour blocks), and asking the same price on transactions entailing different costs...." Scherer and Ross, Industrial Market Structure and Economic Performance, 489 (3d ed. 1990).

Indeed, as the Commission's Notice suggests, "discrimination" can be defined in terms of the utility of the product or service to the buyer. Under such an approach, as well as under a cost-based approach, different prices may in fact not be discriminatory at all.

5. Related Issues.

The Commission also asks whether the buy-through provision should be construed to limit innovative pricing options reflecting "individual subscriber 'customization' of service," and multiple channel discounts that are not channel specific. Notice, ¶8. For the reasons stated above, it should not, provided (i) all customers have the same options, (ii) a subscriber to only the basic service tier can purchase any programming sold on a pay-channel or a pay-for-view program on a stand-alone basis at the same price as any other subscriber purchasing on a stand-alone basis, and (iii) any discounts for a package of channels or programs are not unjustified evasions of the buy-through provision.

The Commission also asks whether the Act effectively precludes the sale of "overlapping tiers on a noncumulative basis". Notice ¶8. Commission regulations should make clear that cable operators can require that a subscriber purchase one tier of program in order to purchase a second tier. By its terms, the Act's buy-through prohibition prohibition applies only to requirements for programming sold on a per channel a per program basis.

D. Conclusion

In sum, for the Commission to prohibit price differentials merely because a program or channel is offered on a low cost basis would run counter to Congress' intent to protect consumers. Rather, the Commission should adopt regulations defining discrimination in a manner narrowly tailored to Congress' intent of prohibiting buy-through requirements. Wherever possible, the Act should be construed to benefit consumers by maximizing their choices and minimizing their costs.

Respectfully Submitted,

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EXHIBIT A

THE LEARNING CHANNEL AFFILIATE RATE CARD

RATE/SUB/MONTH CHARGES FOR SUBSCRIBERS:	1992	1993	1994	1995	1996
1–199,000	$0.070	$0.085	$0.095	$0.110	$0.125
200,000–599,000	$0.065	$0.080	$0.090	$0.105	$0.120
600,000–999,000	$0.060	$0.075	$0.085	$0.100	$0.115
1,000,000–And Above	$0.055	$0.070	$0.080	$0.095	$0.110
Charter Discount/Sub/Mo.	$0.035	$0.040	$0.045	$0.050	$0.055

FOOTNOTES TO TLC RATE CARD

(1) Rates shown above are applicable to systems that carry TLC on their basic tier. Tiering surcharges will be assessed to compensate for lost affiliate and ad revenue if certain system penetration levels are not achieved. Each system's net effective rate will be multiplied by factors shown in the following table:

(2) Subscribers in newly launched cable systems through 1993 are free for a period of twelve months. Subscribers launched in 1994, 1995, and 1996 will be free until the end of that year.

(3) Affiliate agrees to package TLC with a minimum of 5 other 24-hour, ad-supported cable networks carried in their entirety.

SYSTEM PENETRATION:	1992	1993	1994	1995	1996
85%–100%	1.00	1.00	1.00	1.00	1.00
80%–84%	1.00	1.00	1.00	1.12	1.12
75%–79%	1.00	1.00	1.12	1.27	1.27
70%–74%	1.00	1.12	1.27	1.43	1.43
65%–69%	1.12	1.27	1.43	1.61	1.61
60%–64%	1.27	1.43	1.61	1.83	1.83
55%–59%	1.43	1.61	1.83	2.10	2.10
50%–54%	1.61	1.83	2.10	2.40	2.40
40%–49%	2.10	2.40	2.55	2.78	2.78
30%–39%	3.00	3.30	3.60	3.85	3.85
20%–29%	4.40	5.00	5.40	5.80	5.80
10%–19%	8.33	9.00	9.66	10.33	10.33
5%–9%	16.00	18.00	19.50	21.00	23.50
In the event system penetration is below 5%, the following minimum payments per basic subscriber will be charged..	$0.035	$0.050	$0.065	$0.085	$0.110

a Research Survey: Cable's Value on the Slide

D GRANGER

perceived value of networks among fell from a year o a Beta Research d last fall.

the survey of 1,000 cribers (which was gely from multiple de Beta), the monthly suggested they services dipped ar.

ged on top of the ived value among in both 1991 and uggested price fell $2.18. While The hannel scored second s, its "perceived val- m $2.55 in 1991 to

ut the top five for kelodeon, assigned 7, Cable News Net- and MTV: Music $1.37). In 1991, ine News was third, .15, followed by Arts nt Network ($2.04) ly Channel ($1.85). e chart titled "Cable e (among viewers of the average viewers ld pay for the Sci-Fi Channel was $3.11.

CNN ranked number one in a chart asking viewers of each service to rank the importance of basic cable channels. 85 percent of CNN viewers placed the network first.

Discovery was second, with 81 percent, followed by ESPN (78 percent), The Weather Channel and Headline News (75 percent) and USA Network and Nickelodeon (73 percent).

The Beta survey, in its fourth year and funded by various cable networks and operators, is considered a useful, if limited, guide to the tracking of cable networks on a year-to-year basis, according to Tim Brooks, vice president of research for USA.

"Their results are very skewed," he said, "a theme that runs through Beta's research, and I say that despite the fact that we did very well [in the latest survey].

For example, Brooks said, in the current study, new networks were allowed to provide their own descriptions, which Beta was then supposed to make uniform. "Apparently, they didn't," he said.

All studies that attempt to track "value" are also more interpretative than scientific, Brooks said. "The industry as a whole doesn't look at this [Beta survey] as a key report card of the year."

WHAT DO SUBS WANT?

Evaluation of Quality of Programming

Percent of Viewers
Rating 4 or 5
On 5-Point Scale
(5=Excellent, 1=Poor)

Top Ranked Basic Services

Discovery Channel	76%
ESPN	74%
CNN/Headline News	72%
A&E	64%
Nickelodeon	64%
AMC	64%
TLC	63%
Weather Channel	62%
CMT	62%
Family Channel	56%
USA Network	55%

Premium Services

Disney Channel	70%
HBO	58%
Showtime	55%
Cinemax	50%

Interest in New Services

Percent Rating
Interest a 4 or 5
On 5-Point Scale
(5=Excellent, 1=Poor)

Learning Channel	33%
Sci-Fi Channel	25%
Comedy Central	23%
Cartoon Network	20%
CMT	20%
Nostalgia TV	20%
Bravo	18%
E!	16%
Travel Channel	13%

Services Not Launched

ESPN2	35%
Game Show Channel	12%
Game Channel	9%

Source: Results of Beta Research Survey, November 1992

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EXHIBIT B

SERVICE OPTIONS: *AT-A-GLANCE*

BASIC SERVICE - $10.00*

WMAR-2	WBFF-45	Mont. Co. Public Schools
WRC-4	WFTY-50	City of Rockville
WTTG-5	WGN - Chicago	City of Takoma Park
WJLA-7	The Learning Channel	Mont. Co. Government
WUSA-9	WTBS - Atlanta	Local Weather Radar
WBAL-11	C-SPAN	Public Schools TV
WJZ-13	WAW (Univision)	Univ. of Md.-College Park
WDCA-20	The Montgomery Channel	Univ. of Md.-Univ. College
WMPT-22	Montgomery College	The Open Channel
WETA-26	International Channel	NewsChannel 8
WHMM-32		

Basic Service...$10.00*

LIMITED SERVICE - $13.45*

Sci-Fi Channel	BET	Lifetime
Cartoon Network	CNBC	The Interfaith Channel
MTV	E! Entertainment Television	The Learning Channel
The Family Channel	Court TV	C-SPAN II
The Discovery Channel	QVC (shopping)	Cable Plus Preview
Arts & Entertainment	The Nashville Network	Cable Plus pay-per-view and premium channel accessibility
Headline News	VH-1	
Nickelodeon	The Weather Channel	

Basic and Limited Service...$23.45*

PREFERRED SERVICE - $3.00*

ESPN	Cable News Network	TNT
USA Network	American Movie Classics	Comedy Central

Basic, Limited, and Preferred Service...$26.45*

NOTE: There is a $25* change of service charge for existing customers.

You must have Basic Service to receive Limited; you must have Basic and Limited to receive Preferred.