DOCKET FILE COPY ORIGINAL

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

ORIGINAL

In the Matter of	)	
	)	
Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Second Rate Order on Reconsideration and Fourth Report and Order	))))))	MM Docket 92-266

RECEIVED

MAY 16 1994

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

PETITION FOR RECONSIDERATION

Edward Schor, Esq.
Senior Vice President
General Counsel/Communications
VIACOM INTERNATIONAL INC.
1515 Broadway
New York, New York 10036

Richard E. Wiley
Philip V. Permut
Peter D. Ross
Michael K. Baker
WILEY, REIN & FIELDING
1776 K Street, N.W.
Washington, D.C. 20006
(202) 429-7000

May 16, 1994

RECEIVED

MAY 1 6 1994

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

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

In the Matter of	)	
	)	
Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Second Rate Order on Reconsideration and Fourth Report and Order	)	MM Docket 92-266

PETITION FOR RECONSIDERATION

Edward Schor, Esq.
Senior Vice President
General Counsel/Communications
VIACOM INTERNATIONAL INC.
1515 Broadway
New York, New York 10036

Richard E. Wiley
Philip V. Permut
Peter D. Ross
Michael K. Baker
WILEY, REIN & FIELDING
1776 K Street, N.W.
Washington, D.C. 20006
(202) 429-7000

May 16, 1994

No. of Copies rec'd 0+11
List A B C D E

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

In the Matter of	)	
	)	
Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Second Rate Order on Reconsideration and Fourth Report and Order	)	MM Docket 92-266

PETITION FOR RECONSIDERATION

Viacom International Inc. ("Viacom") by its attorneys and pursuant to Section 1.429 of the Commission's rules, hereby seeks reconsideration of several aspects of the Commission's Second Order on Reconsideration, Fourth Report and Order, and Fifth Notice of Proposed Rulemaking modifying and adopting regulations to govern initial permitted cable rates and the adjustment of rates on a going-forward basis.[1]

In revising its rate regulations, the Commission has pursued a strategy of mandating a substantial reduction in initial permitted rates, while intending to allow operators, on a going-forward basis, to recover their investment in the improvement and expansion of cable service. Indeed, the Commission has stated that its going-forward rules are designed, consistent with the Act, to "permit operators to

---

[1] MM Docket No. 92-266, FCC 94-48 (released March 30, 1994) ("Fourth Report and Order").

respond to the marketplace incentives to expand the services included in the regulated program tiers."[2]

Although the Commission's going-forward policy is a step in the right direction, the rules governing new programming expense and the addition of channels fail to achieve the Commission's asserted goal of allowing "operators to grow and develop new facilities and services, including new and innovative regulated programming services."[3] As detailed below, an increase in the new program expense mark-up and the cost adjustment for added channels is critical to preserving cable operators' marketplace incentives to add new and enhanced regulated program offerings.

I. THE COMMISSION'S TREATMENT OF NEW PROGRAMMING EXPENSE AND ADDED CHANNELS FAILS TO ADEQUATELY PRESERVE INCENTIVES FOR INVESTMENT IN THE GROWTH OF REGULATED CABLE TELEVISION SERVICE

In the Fourth Report and Order, the Commission adopted going-forward rules that were devised to permit the cable industry "to continue to grow and provide new and additional services to subscribers."[4] Specifically, the Commission allowed operators a 7.5% mark-up on new programming expense and a "network cost adjustment" for the non-programming costs

---

[2] Id. at ¶ 22.

[3] Id. at ¶ 238.

[4] Id. at ¶ 238.

incurred in adding a new programming service. While these going-forward mechanisms are critical to the growth of the industry, the rules as enacted do not sufficiently compensate operators for the risks and costs they incur in investing in new and high quality programming. Accordingly, the Commission should revise its rules to increase the mark-up and network cost adjustments.

A. 11.25% Is a Reasonable Mark-up on New Programming Expense

The Commission, in the cost-of-service proceeding, has selected 11.25% as a reasonable rate of return on a cable operator's investment in regulated service.[5] In the Cost-of-Service Order, the Commission derived an overall rate of return for cable service by using the weighted average cost of capital method, with its cost of equity, cost of debt, and capital structure components.[6] The Commission, after reviewing the studies of multiple economic experts, conducting a separate cost of equity analysis, and considering the matter for almost twenty-five pages, determined that a rate of return on regulated cable service

---

[5] Report and Order and Further Notice of Proposed Rulemaking in MM Docket No. 93-215, FCC 94-49 (released March 30, 1994) at ¶ 148-208 ("Cost-of-Service Order").

[6] Id. at ¶ 164.

of 11.25% was reasonable.[7] In contrast, the Commission, despite its determination to retain incentives for investment in programming, picked an avowedly "cautious" 7.5% mark-up on new programming expense after noting only that "the mark-up on programming expense should be less than the rate of return on longer term investment in assets such as tangible plant in service."[8]

Regardless of the timing difference of recovery, however, the cable operator is not receiving as significant a return on its investment in programming as in any other facet of its operations. Viacom believes that this is not good public policy and contravenes the 1992 Cable Act's objective of promoting programming. See 1992 Cable Act at §§ 2(b)(1), 2(b)(3) (policy of the Act is to expand cable television, in general, and video programming services, in particular). Because operators must share some of the risk of a program service's success or failure, the continued growth of cable programming depends on the willingness of operators to undertake that risk. Operators will be less likely to assume the risks of programming investment and allocating channel capacity to new and untried program services if the "upside

---

[7] While Viacom does not believe that 11.25% is an appropriate rate of return, the return on programming should be no less than the return on all other aspects of regulated cable service.

[8] Fourth Report and Order at ¶ 246 n.345.

potential" -- the mark-up on the investment -- is too low. Thus, an adequate return on programming investment is especially critical to the vitality of the programming industry. Given the symbiotic relationship between operators and programmers, it is entirely appropriate to raise the return to 11.25%.

B. The Network Cost Adjustment Should Be Increased

Compounding the harms caused by a low mark-up, the network cost adjustment for added channels does not provide operators sufficient incentives to add channels. The Commission's going-forward methodology permits operators to adjust non-programming "network" costs by a specified amount per channel when the total number of regulated channels increases.[9] Although the Commission has appropriately recognized that operators, in adding channels, incur costs over and above external programming costs, the network cost adjustments as calculated do not compensate operators for channel addition costs and therefore must be increased.

The Commission's calculation of the network cost adjustments is contrary to its professed goal and should be revisited. The FCC recognizes that the goal of the network

---

9 See generally id. at ¶¶ 239-247 and Appendix C (Technical Appendix) at pp. 25-31.

adjustment is to allow operators to recover their non-external costs.[10] The method used to calculate the adjustments, however, is derived from benchmark equations and data that are based not on operators' costs, but rather on the average rates charged subscribers.[11] This approach is not logical.

Moreover, while Viacom has yet to empirically assess the necessary level of network cost adjustments, it is intuitive that a $0.01 adjustment -- the amount for an average number of channels of 46.5 and up -- is simply not enough to restore an operator's marketplace incentive to add channels. Nor are the amounts for smaller cable systems significantly more remunerative: the addition of a channel to a system with an average of 46 channels entitles the operator to a $0.02 adjustment; the addition of a channel to a system with an average of 35 channels occasions a $0.03 network adjustment. These meager amounts are particularly unacceptable given the fact that many -- if not most -- cable systems can be expected to attain channel capacities in this vicinity in the near future. Consequently, the Commission should boost the

---

[10] Id. at ¶ 243; Appendix C at p. 25.

[11] First Order on Reconsideration, Second Report and Order, and Third Notice of Proposed Rulemaking, MM Docket No. 92-266, FCC 93-428 (released August 27, 1993) at ¶ 142 n.251 ("the benchmark is based on average industry rates.").

network cost adjustment to preserve the existing marketplace incentives that make new programming possible.

II. CONCLUSION

For the foregoing reasons, Viacom respectfully urges the Commission to increase the new programming expense mark-up and the network cost adjustment. These modifications of the going-forward rules will better serve the policy goals of the 1992 Cable Act by ensuring that operators continue to invest in new and improved program services.

Respectfully submitted

VIACOM INTERNATIONAL INC.

By: Philip V. Permut /MKB

Richard E. Wiley
Philip V. Permut
Peter D. Ross
Michael K. Baker
WILEY, REIN & FIELDING
1776 K Street, N.W.
Washington, D.C. 20006
(202) 429-7000

Edward Schor, Esq.
Senior Vice President
General Counsel/Communications
VIACOM INTERNATIONAL INC.
1515 Broadway
New York, New York 10036

May 16, 1994