

DOCKET FILE COPY ORIGINAL

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)
)
Rate Regulation)

MM Docket No. 92-266

RECEIVED

JUL 29 1994

REPLY COMMENTS OF
LIBERTY MEDIA CORPORATION

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Liberty Media Corporation ("Liberty Media") submits these reply comments in response to selected comments in this proceeding. The record clearly demonstrates that the current "going-forward" rules simply are not working and have stifled the expansion of regulated service offerings. Reasonable fixed rate increases will more adequately compensate cable operators for adding new services to regulated tiers, thereby potentially relieving the existing gridlock in the programming marketplace.

I. The Current Rules Provide Inadequate Incentive To Expand Regulated Service Offerings And May Distort Carriage Decisions.

In its Second Order on Reconsideration, Fourth Report and Order, and Fifth Notice of Proposed Rulemaking, MM Docket No. 92-266, FCC 94-38 (rel. Mar. 30, 1994) ("Fourth Report" and "Fifth Notice"), the Commission simultaneously:
(a) adopted rules designed to enable cable operators to expand

No. of Copies rec'd 0+10
List ABCDE

regulated service offerings by allowing them to recover the programming cost of new services plus a 7.5 percent "mark-up" and a one or two cent "network adjustment" for each new programming service added to a regulated tier (Fourth Report at ¶¶246-247); and (b) questioned whether those rules "should be modified to provide greater or lesser compensation to operators for adjustments to capped rates when channels are added" (Fifth Notice at ¶256).

In its initial comments, Liberty Media reported that rate regulation had created "gridlock" in the programming marketplace which could not be relieved by the current going-forward rules. Liberty Media Comments at 4. Virtually every other programmer has reported that the Commission's rate regulations, particularly the "going-forward" rules, have stunted the growth of existing services and stalled efforts to launch new services:

- "The regulatory bar to new 'basic' channels has crippled the growth of Court TV." Comments of Court TV at 11.
- "Since the benchmark/price cap regime went into effect, operators have been very reluctant to add The Learning Channel to their system...." Comments of Discovery Communications, Inc. ("Discovery") at 6.
- "During the past eighteen months, program networks like E! have experienced a frustrating halt to growth....[L]aunches of E! by new affiliates have reached a standstill." Comments of E! Entertainment Television, Inc. ("E!") at 6.

- "[T]he Commission's approach has stalled the growth of ME/U [Mind Extension University] [and] its effect on new services that JEN hopes to launch in the near future will be even more severe, if not fatal." Comments of Jones Education Networks ("JEN") at 5.
- "[T]he Commission's current rules pose a direct threat to the economic viability of Lifetime and other established low fee, high quality program services...." Comments of Lifetime Television ("Lifetime") at 1-2.
- Since the rate regulations took effect "we have experienced no significant growth in subscribers [and] [w]e are far from being alone in experiencing this Commission-induced 'freeze'; BET, the Disney Channel, E! and Encore (among others) state that they also are encountering problems signing up cable systems for carriage of their services in regulated tiers." Comments of USA Networks ("USA") at 4.

In short, the 7.5 percent mark-up on programming costs and "network adjustment" factor are inadequate for cable operators to add services to regulated tiers.

The percentage mark-up on programming costs under the current rules clearly is insufficient and requires unrealistically high license fees to generate cable operator revenues sufficient to justify expansion of regulated service offerings. See, e.g. JEN Comments at 4 ("To enable an operator to keep an extra penny under a 7.5% mark-up approach, a programmer would need to increase its fee to the operator by 13.33 cents"); Comments of Cablevision Industries Corporation ("CVI") at 11 (If "a cable operator needs to retain at least 35-40 cents per subscriber in increased rates to justify adding a particular service...[it] can only retain this amount

if the programmer charges it \$4.67 per subscriber per month"). Rules which create such perverse incentives clearly do not serve the interests of cable operators, programmers or subscribers.

In addition, the network adjustment factor -- which apparently is intended to allow cable operators to recover the non-programming costs involved in adding a new service -- is neither related to those costs nor sufficient to cover them. See, e.g. Comments of Time Warner Cable ("Time Warner") at 5 (a cable operator adding a new service to a system with 46 regulated channels "would take over 14 months just to recover the postage costs incurred in sending the required subscriber notices"); Comments of the National Cable Television Association ("NCTA") at 6 (the network adjustment factor "is based on observations of average rates for 'competitive systems' in September 1992...[and] does not indicate how cable systems behaved when channels were added to existing tiers"); CVI Comments at 7 ("costs of headend equipment alone" far exceed the allowable adjustment).

The current incentives also are insufficient to overcome the substantial barriers to adding new programming services on regulated tiers resulting from other, non-rate related regulations. See, e.g. NCTA Comments at 9-10 ("under the Commission's current interpretation of its rules, an operator raising a rate where a channel is added to a cable programming service tier opens up that entire tier rate to

attack by a complaining subscriber"); Lifetime Comments at 19 ("New ground rules for cable operators' pass-throughs of external costs to subscribers create a needless delay in the recovery of increased external costs on the basic tier"); Time Warner Comments at 22 ("The Commission...has unwisely allowed state and local governments not merely to enforce the federal negative option prohibition...but to establish their own 'negative option' restrictions, some of which go far beyond any rational understanding of that term").

In addition to being generally inadequate to promote the addition of new programming services, the current going-forward rules may distort carriage decisions by potentially discriminating against low-cost or no-cost programming services. See JEN Comments at 4 (because of percentage mark-up, "operators are now simply unwilling to add ME/U even when we offer it at very low rates"); E! Comments at 3 (percentage mark-up "serves as a disincentive for operators to add lower cost services like E! or others that are offered at no cost"); Lifetime Comments at 7 ("strong incentives have been created for operators to remove low fee services from broad tiers [and] replace them with high fee services"); Comments of Providence Journal Company ("Providence") Comments at 4 (current rules create "an imbalanced playing field...[which] disadvantages low cost and no cost programming"); USA Comments at 10 ("invidious discrimination...arises under the existing methodology").

II. The Commission Should Adopt Reasonable Fixed Rate Increases For Adding New Services To Regulated Tiers.

Commenters uniformly agreed that adoption of a reasonable fixed rate increase for each new service added to a regulated tier -- either as a replacement for or an alternative to a percentage mark-up on programming costs¹ -- would provide greater incentives for cable operators to expand regulated service offerings. Liberty Media supports adoption of a fixed rate increase within the range suggested by the other commenters. See, e.g., Comments of Tele-Communications, Inc. ("TCI") at 24 (25 cents); USA Comments at 9-10 (25 cents plus a 5 cent "adjustment factor"); CVI Comments at 14 (35 to 40 cents). See also Comments of the Cable Telecommunications Association at 4-5 (sliding scale of 25 cents to 50 cents depending on system size).

The record indicates that increases in that range -- in addition to a pass-through of the license fees for new programming services -- are necessary to compensate cable operators for adding new services to regulated tiers. See, e.g., CVI Comments at 10 ("it would be difficult to justify adding

¹ Commenters proposing to retain a mark-up on programming costs as an alternative to the fixed rate increase advocated a substantial increase in the current 7.5 percent mark-up. See, e.g., Providence Comments at 6 (advocating an "improved percentage mark-up" alternative); Time Warner Comments at 6 (25 percent of programming costs); Discovery Comments at 9 (a reasonable mark-up should be at least 11.25 percent based on cost-of-service rate of return, and as much as 25 percent if based on rate of return for other entertainment businesses).

a channel to one of our regulated tiers unless we could count on recovering...at least 35 to 40 cents more than the cost of the programming"); USA Comments at 10 (although "[n]either we nor the Commission can be sure that 25 cents" provides a sufficient incentive to add new services, such an increase "[c]ertainly...is not too high"). Moreover, the survey data and analysis presented by TCI indicate that historical rate increases to account for the addition of new programming services, if adjusted by the Commission's "competitive differential" and estimated conservatively, would yield net increases of \$0.21 to \$0.34, excluding program costs. TCI Comments at 24.

Although this fixed rate approach will better enable cable operators to add new services to regulated tiers, it will not eliminate cost-based discrimination in carriage decisions. The Commission should recognize that when applied to higher-cost services, a fixed rate increase will yield a lower margin to the cable operator. Consequently, the fixed rate approach may be more "neutral" in terms of its effect on carriage decisions than the current percentage mark-up, but it discriminates to some extent against higher-cost services.

Certain parties have suggested that an annual cap on rate increases resulting from the addition of new programming services would eliminate any potential concern over excessive rate increases. If the Commission considers annual rate caps, Liberty Media respectfully suggests that such caps be applied

in an even-handed manner to avoid creating further bias against carriage of higher-cost services, particularly local and regional news and sports services which provide significant public interest benefits to viewers.² Because elimination of the percentage mark-up on programming costs under the fixed fee approach removes any artificial regulatory incentive to add high-cost services, cable operators will add such services only where there is substantial subscriber demand for them. Consequently, any annual cap should apply only to that portion of the rate increase which constitutes the "fixed" per channel increase, not the cost of the newly added programming. At a minimum, the Commission should exclude the cost of local and regional news and sports services from any annual cap -- or provide a simple and effective waiver procedure -- in order to avoid discouraging carriage of those services.

² The Commission has recognized that local and regional programming services are more expensive than other services because they are "costly to produce and appeal only to a limited population of subscribers." Second Report and Order, MM Docket No. 92-264, 8 FCC Rcd. 8565 (1993), at ¶78; see also New England Cable News, Docket No. CSR-4231-P, FCC 94-133 (rel. June 1, 1994) ("NECN") at 14 ("[W]hat makes NECN different from other programming services, and even differentiates it from other new programming services, is the regional nature of its programming and audience appeal. Because this service by definition appeals to a much smaller potential subscriber base, it has a naturally limited distribution potential. The limited extent of the target market from which NECN can secure carriage reduces potential revenues from distribution as well as advertising.")

Conclusion

Rate regulation and the inadequate incentives under the "going-forward" rules continue to inhibit the expansion and development of cable programming services. To ease this "gridlock," the Commission should permit a reasonable fixed rate increase plus the license fee for each new service added to a regulated tier. In addition, license fees should be excluded from any annual cap on rate increases for programming services added to regulated tiers, particularly for local and regional programming services.

July 29, 1994

Respectfully submitted,



Robert L. Hoegle
Timothy J. Fitzgibbon
Carter, Ledyard & Milburn
1350 I Street, N.W., Suite 870
Washington, D.C. 20005
(202) 898-1515

Attorneys for
Liberty Media Corporation