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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

BEFORE THE

Federal Communications Commission

WASHINGTON, D.C.

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In the Matter of	)	
	)	
Implementation of Sections of	)	
the Cable Television Consumer	)	MM Docket No. 92-266
Protection and Competition	)	
Act of 1992: Rate Regulation	)	

PETITION FOR RECONSIDERATION

QVC, INC.

WILLKIE FARR & GALLAGHER
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20036
(202) 328-8000

ITS ATTORNEYS

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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

PETITION FOR RECONSIDERATION

QVC, Inc., by its attorneys, petitions the Commission pursuant to Section 405 of the Communications Act, 47 U.S.C. § 405, and Section 1.429 of the Commission's Rules, 47 C.F.R. § 1.429 to reconsider one aspect of its Going Forward Order in the above-captioned docket,[1] specifically, the apparent requirement that cable operators adding home shopping channels offset their increased network costs with revenues earned from this particular set of programmers. This requirement is inconsistent with the objectives of the Going Forward Order, and unfairly sets out a particular programming format for unique and unfavorable treatment. In doing so, it violates both the Commission's obligations under administrative law principles to treat similarly situated firms similarly, and its commitment to

[1] Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation, MM Docket No. 92-266, Sixth Order on Reconsideration, Fifth Report and Order, and Seventh Notice of Proposed Rulemaking, FCC 94-286 (released November 18, 1994) (Going Forward Order). The Order was published in the Federal Register on December 6, 1994. 59 Fed. Reg. 62,614.

avoid disruption in and interference with the competitive programming markets. In any event, the rule is not rational because it will predictably not succeed in foreclosing the opportunities for evasion which apparently first drove the concept of offsets.

I. INTRODUCTION

QVC, a publicly traded company with part of its equity held by cable multiple system operators (MSOs), is the leading producer of electronic video retailing programming. In addition to its well-known "QVC" home shopping channel, the company launched in June 1994 a new channel called "Q2" to more fully address underserved markets.

The initiation of a new channel against the backdrop of the implementation of cable rate regulation has been a difficult and costly process. As the Commission itself recognized, the initial rules for adding channels substantially discouraged operators from doing so. In response, Q2 offered cable operators substantial financial incentives as an inducement to add it to their systems. With the newest rules, however, even the sizeable launch incentives now offered by Q2 have been overwhelmed. Q2 has simply been unable to successfully negotiate any significant carriage agreements with MSOs under the handicap created by the new rules. Unless the Commission is prepared to materially impede the growth of electronic retailing, it should reconsider and/or clarify its rules such that no offset of network costs is required by the payment of consideration from programmers to cable operators.

II. BY REQUIRING OFFSETS FOR SALES COMMISSIONS, THE NEW RULE CREATES MATERIAL PROBLEMS FOR ELECTRONIC RETAILERS.

The Going Forward Order allows cable operators to add channels at a cap of 20 cents (representing network costs) plus additional amounts of programming costs, with a total cap for the first two years of $1.20 per month. In year three the cap increases to $1.40. There is an additional 30 cents "license reserve fee" which represents the opportunity for cable operators to pass through additional programming license fees.

At paragraph 74, however, the Order dictates that any revenues received by the cable operator from programmers or shared with programmers must offset any rate increase that would otherwise be allowed by adding a channel.[2] The Order further provides that such revenues shall be used to offset program costs

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[2] The relevant language provides:

> In the Rate Order, we provided that any revenues received from a programmer, or shared by a programmer and an operator, must be netted against costs for purposes of calculating whether there has been an increase or decrease in external costs. We extend this requirement for offsetting revenues against costs to the per channel adjustment factor for channels added to CPSTs pursuant to our revised channel adjustment rules. The revenues must be deducted from programming costs and then, to the extent revenues are remaining, from the per channel adjustment. Offsetting will apply on a channel-by-channel basis.

Going Forward Order at ¶ 74.

and, if there is any excess revenue remaining, then those revenues received must be used to offset the 20 cents per channel which would otherwise be allowed in the network cost adjustment. Footnote 27 specifically mentions "commissions" as a source of revenues which would trigger the offset requirement.[3] The Order makes clear that the offset occurs only on a channel-by-channel basis.

The new language has created critical problems for home shopping channels competing with other programmers for access to channel capacity on cable systems. Under the Order, advertiser-supported programming networks offer cable operators the opportunity to earn the 20 cents plus programming costs (obviously within the total cap allowed) plus other sources of revenue untouched by the rules (e.g., advertising availabilities). In contrast, programmers with home shopping formats can offer cable operators the opportunity to earn only up to the 20 cents. Worse yet, the uncertainties and the mechanics of the offset regulation require operators to incur material

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[3] The footnote reads:

> Commissions received by an operator from programmers will be treated as revenues received from programmers. Any commissions cable operators receive from programmers must, therefore, be netted against programming costs for the purpose of determining whether there has been an increase or decrease in the operator's external costs. After commission revenues have been deducted from programming costs, if there are still revenues remaining, such revenues shall be deducted from the per channel adjustment.

Id. at n. 27.

transactions costs which chill their interest in adding new home shopping channels.[4] Simple economics favor traditional formats under the rule because cable operators can earn more from them independent of which programming consumers may value more. And because there is a surplus of programming in relation to the amount of available capacity, the Order has resulted in stifling the addition of home shopping channels under the new rules.

III. THE OFFSET REQUIREMENT FOR SALES COMMISSIONS IS INCONSISTENT WITH THE OVERALL RATE REGULATION POLICIES.

The origin of requiring cable operators to offset cost increases with revenues received from programmers can be traced to the FCC's initial rules for passing through programming cost increases directly to subscribers. In the First Rate Order, the FCC decided to permit programming cost increases experienced by cable operators to be passed through to subscribers, along with a 7.5% mark-up.[5] Out of apparent concern that these permitted pass-throughs could be artificially inflated through rebates or side payments, the First Rate Order further required that revenues coming in from programmers must be used to offset

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[4] There are also material questions left unanswered in the Order over the sheer mechanics of the offset. For example, how often must the offset occur? Based on revenues from what time period? What amount of "lag" is permissible? What adjustments are required, if any? These questions suggest that, even from a static perspective, the costs alone of the requirement are not worth any conceivable benefit to consumers. Of course, the dynamic effects condemn the rule even more.

[5] Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation, MM Docket No. 92-266, Report and Order, 8 FCC Rcd 5631, ¶ 253 (1993) (First Rate Order).

permitted programming cost increases.[6] Advertising revenues, however, were exempted from this requirement, without explanation.

The initial rules were clarified and/or waived in a series of letter opinions issued to programmers concerned that the new rules created special imbalances among types of programming, discouraged carriage of new programming, or caused confusion in the programming marketplace requiring further clarification by the agency.[7] These letters, issued to a variety of programmers including Fx, MTV, Disney, QVC and others, established a number of additional rules and clarifications. For Q2, a new home shopping network, the Cable Services Bureau clarified that neither sales commissions nor launch incentives paid by Q2 to cable operators would trigger offset requirements since the payment mechanisms between programmer and operator all run in the same direction, that is, no monies are paid by the cable operator to the programmer in license fee or other form.[8] More generally, the letters as a group reflected a concern that new programming not be discouraged and that different types of programming should not be artificially aided or hampered by the regulatory scheme.[9]

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6 Id. at n. 602.

7 See, e.g., In re Small Cable Business Association, released August 3, 1994; In re The Disney Channel, released May 23, 1994.

8 In re QVC Network, Inc., released May 6, 1994.

9 For example, MTV Networks, Inc. successfully sought a waiver of the offset requirement, having urged treatment it (continued...)

In the Going Forward Order, the FCC reinforced its policy objective of facilitating new programming networks by improving the incentives of cable operators to add new channels. Among other things, the new rules allow cable operators to recover the network costs of activating channels up to 20 cents -- termed the "per channel adjustment factor" -- as well as recovery of programming costs. The 20 cents increase represents the operator's "costs of adding the channel plus a reasonable profit . . . exclusive of programming costs."[10] The cable operator's programming costs, that is, the consideration paid by cable operators for programming, are regulated separately and subject to different constraints than are the network costs.

A. Cable Operators Should Be Allowed to Recover Network Costs Regardless of the Nature of the Transactions with Different Types of Programmers.

The per channel adjustment factor represents only the network costs of adding channels -- independent of the value or cost of the programming occupying that channel. This fact is crucial because it is only the programming cost passed through to subscribers which is potentially vulnerable to manipulation and artificial inflation by alteration of the programmer-distributor contract. The network costs, in contrast, are more stable, more

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[9](...continued) viewed as co-equal with full-time home shopping formats. See In re MTV Networks, released August 3, 1994.

[10] Going Forward Order at ¶ 73. The 20 cents per channel substitutes for earlier rules that had allowed operators to recover on average only 1-2 cents for network costs.

subject to objective verification, and because they are capped in any event, are not subject to the sort of inflation or manipulation which fueled the adoption of the offset rule.

As the Going Forward Order describes, the 20 cents figure "falls within the historical range of 15-22 cents by which cable operators in a competitive environment would adjust rates for the addition of a new programming channel, exclusive of programming costs."[11] As more fully explained in the Technical Appendix to the Order,

> The per channel adjustment factor is the maximum permitted rate increase (for non-programming costs) for each channel an operator adds to its system's CPSTs. The adjustment factor reflects the cost that an operator facing effective competition would incur.[12]

Programming costs were adjusted for and thus removed from this calculation.[13]

Because the per channel adjustment factor is not subject to the manipulation sought to be curtailed by the offset requirement, the original purpose of the offset rule is inapplicable here. In fact, use of an offset is inconsistent with the purpose of the per channel adjustment factor since the increased network costs represented by the 20 cents are incurred by the adding of a channel regardless of the nature, quality, or profitability of the programming carried on that additional

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11 Going Forward Order at ¶ 73.

12 Id., Technical Appendix at 2.

13 Id. at 3.

channels. Thus, there is a plain disconnect between the stated purpose of the rule and its overall context.

The new going forward rules for adding channels, by virtue of the caps contained in them, no longer carry with them the same incentive or ability inherent in the initial methodology, that is, cable operators are unlikely to try to deliberately circumvent rate level constraints by recording contrived programming cost increases not actually experienced. Whereas the initial rules permitted programming cost increases flowing from the addition of channels to be passed through without limit, the new rules cap the amount that can be passed through to subscribers at $1.50. The cap serves to eliminate incentives to artificially inflate costs. Thus, the offset rule has lost much of its prior rationale, and need not and should not be applied to operators using these rules.[14]

The new requirement is also inconsistent with the underlying effort behind rate regulation in general -- to require cable operators to charge rates comparable to those charged by systems subject to "effective competition." This basis for regulating rates does not attempt to calculate or account for home shopping revenues in any way. The rates for "effectively competitive" systems were studied without regard to home shopping revenues earned by those systems. This revenue source was wholly outside

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[14] Even if the Commission believes the offset still serves some purpose under the new rules, the offset should be confined to programming costs, leaving the per channel adjustment factor undisturbed.

the analytical process -- unsurprisingly, since there is every reason to believe that "competitive" systems earn home shopping revenues in step with comparable "non-competitive" systems.

The new regulated rates are intended to approximate competitive rates. The "competitive" systems will continue to gain increased revenues from home shopping without concern that somehow these increased revenues reflect the exploitation of market power. There is no apparent policy rationale for effectively disallowing comparable earnings for regulated systems.[15]

More broadly, the rules reflect an impossible undertaking, that is, an attempt to regulate precisely the amount of monies earned by cable operators for each new channel added. This effort is doomed from the beginning since the regulations have included some revenue sources but deliberately excluded others. Thus, it cannot be accurately stated that the regulations are designed to allow cable operators to earn up to but no more than 20 cents, since cable operators are free to earn more through

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[15] A recent letter ruling by the Cable Services Bureau expresses a concern for arrangements in which programming license fees are passed through to subscribers but not offset by payments made from the same programmer to the cable operator. Such arrangements, the Bureau explained, are inconsistent with the offset rule. See In re Black Entertainment Television, released December 21, 1994. Of course, this ruling does not address situations where, as here: 1) all payments run in one direction, i.e., from the programmer; and 2) the cable operator does not seek to pass through programming costs to end users but rather to recover the network costs of adding a channel. As explained above, the latter has been determined by the FCC to fairly reflect the reasonable costs appropriately recovered by cable operators from their customers for adding a channel regardless of the nature of the programming transmitted over that channel.

advertising availabilities and other forms of consideration received from programmers. Rather, the 20 cents cap regulates the amount of money a cable operator can charge a subscriber; it does not and can not address other sources of revenues. This is only appropriate, given that rate regulation is intended to safeguard against the exercise of market power vis-a-vis consumers. It is not intended to regulate wealth transfers between and among programmers and distributors.

In any event, the Commission could hardly expect to be able to police all the various types of consideration which could be devised in order to stay on the right side of the regulation. It has in fact omitted some forms of consideration while including others without any explanation whatsoever. The effort also appears to be at odds with the stated policy objectives of the going forward methodology -- simplicity and flexibility.

B. The Offset Requirement Violates the FCC's Commitment to Regulating Cable Operators while Preserving Programmer Neutrality.

The Commission's policy goal to remain programmer-neutral is severely undermined by applying the offset rule to sales commissions or launch incentives. The Going Forward Order was crafted expressly to avoid regulatory spillover effects in the programming markets. The FCC made clear that its Order

> makes no judgment about the relative value to subscribers of high or low cost channels, but seeks to replicate the incentives operators would have to add

> channels in a competitive market, which accommodates both low and high cost services.[16]

The letter rulings similarly had implicitly evinced a concern that the old cable rules for adding channels may have disadvantaged some programmers vis-a-vis others. No doubt it was for this reason that the FCC allowed various new and existing programmers substantial flexibility in dealing with cable operators through the issuance of waivers and liberal constructions of the rate regulations.

The new rules issued in the Going Forward Order do not achieve the stated policy objective of neutrality. Home shopping networks now are at a significant disadvantage if commissions are required to be used to offset allowable rate increases. In the case of sales commissions, an offset rule grossly favors programming networks which offer cable operators alternative sources of revenues that are not required to be offset, most prominently, advertising revenues. In the case of launch incentives, it cuts off an attractive and important marketing technique for new programming networks -- a means by which new programmers are able to share with cable operators the uncertain risk of distributing untested programming. Thus, traditional programming formats are favored over new home shopping networks, and entrenched programmers are artificially advantaged over new entrants.

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16 Going Forward Order, Technical Appendix at 30.

The price for discouraging new electronic retailing sources may be paid in more hidden ways as well. Undoubtedly, these services are the forerunners to the interactivity of the information superhighway which all policymakers are seeking to promote. Notwithstanding this, the FCC rule blatantly favors more traditional marketers -- both those retailers distributing in unregulated markets, as well as programmers that seek to attract cable operators through compensation in the form of traditional advertising availabilities. Why the FCC should deem one form of compensation acceptable (and thus unregulated) yet severely constrain the other is left wholly unexplained. QVC respectfully submits that the record will not support such disparate treatment. The disparity is therefore unlawful. See, e.g., McElroy Electronics Corp. v. FCC, 990 F.2d 1351, 1365-1366 (D.C. Cir. 1993) ("remind[ing] the FCC of the importance of treating similarly situated parties alike or providing an adequate justification for disparate treatment"); Melody Music Inc. v. FCC, 345 F.2d 730 (D.C. Cir. 1965) (FCC under legal obligation to treat similarly situated firms alike); Northeast Cellular Telephone Co. v. FCC, 897 F.2d 1164 (D.C. Cir. 1990).

IV. CONCLUSION

The Commission has consistently recognized the need to craft its rate regulations for cable services in ways which minimize to the greatest extent possible disruptions to the programming markets. The Going Forward Order, by requiring offsets for home shopping networks added by cable operators under the new rules, imposes precisely the type of consequences the FCC has tried elsewhere to avoid. Moreover, time is of the essence in rectifying this problem, since cable operators have already begun to add channels under the new rules and will shortly (if not having done so already) reach the limits imposed either by the rules or by capacity constraints.

For all these reasons, QVC respectfully urges the Commission to reconsider its Going Forward Order and eliminate the offset requirement for revenues paid by programmers in the form of sales commissions or launch incentives.

Respectfully submitted,

QVC, INC.

Sue D Blumenfeld

Philip L. Verveer
Sue D. Blumenfeld
Melissa E. Newman
WILLKIE FARR & GALLAGHER
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20036

ITS ATTORNEYS

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