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

FCC 95-343

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	)	
	)	
Implementation of Sections of	)	
the Cable Television Consumer	)	MM Docket No. 93-215
Protection and Competition	)	
Act of 1992: Rate Regulation	)	

TWELFTH ORDER ON RECONSIDERATION

Adopted: August 7, 1995 Released: August 8, 1995

By the Commission: Commissioner Ness dissenting and issuing a statement.

I. Introduction

1. In the *Sixth Order on Reconsideration, Fifth Report and Order, and Seventh Notice of Proposed Rulemaking ("Going Forward Order")*,[1] the Commission adopted rules providing incentives for cable operators to add new channels to their cable programming service tiers. Those rules allow operators a per channel mark up of up to 20 cents. With respect to home shopping channels, however, operators are required to offset this mark up with sales commissions revenues received from such channels. Several programming entities, including Home Shopping Network, Inc. and QVC, Inc., filed petitions for reconsideration of the sales commission offset requirement. In this Twelfth Order on Reconsideration, the Commission grants these petitions for reconsideration and eliminates the

[1] Sixth Order on Reconsideration, Fifth Report and Order, and Seventh Notice of Proposed Rulemaking, MM Docket No. 92-266, MM Docket No. 93-215 (November 10, 1994), 10 FCC Rcd 1226 (1995).

home shopping offset requirement.[2]

II. Elimination of Offsets

A. Background

2. Generally, an operator will pay a licensing fee to a programmer for the right to carry that programmer's service. This licensing fee, or program cost, is part of the overall cost that a programmer can recover as an "external cost" when rates are adjusted to account for the addition of a program service to an operator's channel lineup.[3] In an effort to ensure that an operator's program cost reflects the actual cost of carrying a program service, the Commission, in the Report and Order and Further Notice of Proposed Rulemaking, required that revenues received from a programmer, or shared by a programmer with an operator, be netted against programming costs when calculating net programming costs that can be recovered through regulated rates.[4]

3. In the *Going Forward Order*, the Commission established new rules governing the amount by which an operator can mark up its rates in addition to license fees to account for the addition of new channels to its CPST.[5] These rules establish a mark up per channel of up to 20 cents subject to an overall cap of $1.20 for the first two years. Moreover, in that Order, the Commission applied the revenue offsetting requirement to the per channel mark up for channels added to Cable Programming Service Tiers ("CPSTs"). Specifically, the *Going Forward Order* provided that revenues received from programmers must be deducted from programming costs and, to the extent revenues remain, from the operator's

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[2] This Order resolves reconsideration petitions challenging the home shopping revenue offset requirement. It does not resolve other pending petitions for reconsideration of the *Going Forward Order*.

[3] External costs are costs that may be recovered by the operator in adjustments to previously established rates, including programming costs, franchise fees, state and local taxes applicable to the provision of cable television service and other cost items set forth in 47 C.F.R. § 76.922(d)(3)(iv).

[4] Report and Order and Further Notice of Proposed Rulemaking, 8 FCC Rcd 5631 n.602 (1993). *See also* 47 C.F.R. § 76.922(d)(3)(x). The Cable Services Bureau previously clarified that customary and verifiable promotional costs paid by programmers to operators do not require offsetting. See Letter from Acting Chief, Cable Services Bureau to The Disney Channel (May 19, 1994).

[5] *Going Forward Order*, 10 FCC Rcd. at 1252.

mark up. Offsetting applies on a channel-by-channel basis.[6] In addition, the *Going Forward Order* reaffirmed that commissions received by an operator from programmers will be treated as revenues received from programmers. Thus, commissions received by operators must first be netted against programming costs. Remaining commission revenues must be deducted from the per channel adjustment.[7]

B. Petitions for Reconsideration

4. A number of parties filed petitions for reconsideration in response to the *Going Forward Order*. Home shopping entities such as QVC, Inc. ("QVC") and Home Shopping Network, Inc. ("HSN") contend that requiring operators to offset the operator's mark up with sales commissions discriminates against home shopping services. They argue that other programming networks offer advertising availabilities to operators and the value represented by such advertising availabilities is not offset against programming costs or the channel adjustment.[8] In their view, this establishes a regulatory disincentive to add home shopping while encouraging the addition of traditional programming.[9] Moreover, QVC contends that mark ups for channels added to the CPST reflect "network costs" which, unlike programming costs, are not as susceptible to manipulation or artificial inflation.[10] Consequently, QVC argues, a primary purpose for restricting external cost recovery to net operator cost is absent in the case of network cost recovery embodied in the operator's mark up.[11] HSN and Jones Infomercial Network further contend that the regulatory complexity and burdens associated with the accounting and offset of commission revenues discourage

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[6] *Going Forward Order*, 10 FCC Rcd. at 1252, to be codified at 47 C.F.R. §§ 76.922(d)(3)(x), 76.922(e)(3)(ii). In previous letters, the Cable Services Bureau clarified that offset requirements are applied on a channel-by-channel basis. *See* Letter from Chief, Cable Services Bureau to Home Shopping Network (May 6, 1994); Letter from Chief, Cable Services Bureau to QVC Network, Inc. (May 6, 1994).

[7] *Going Forward Order*, 10 FCC Rcd. at 1252.

[8] Advertising availabilities, also referred to as "ad avails," are time slots set aside by the programmer for use by the cable operator. A cable operator, in turn, can sell the time slot to local advertisers.

[9] QVC Petition at 11-13; Home Shopping Network (HSN) Petition at 3-6.

[10] QVC describes network costs as the cost "incurred by the adding of a channel regardless of the nature, quality, or profitability of the programming carried on that additional channels." (sic) (emphasis in original). QVC Petition at 9-10.

[11] QVC Petition at 7-10.

operators from adding home shopping channels.[12] Furthermore, Petitioner Black Entertainment Television ("BET") argues that the elimination of the offset for sales commission revenues could benefit subscribers by allowing sales commission revenues to cover some of its channel's operating costs. In turn, BET asserts, operators would be less inclined to raise subscriber rates for the service.[13] BET also contends that the offset rule discourages operators from carrying niche programming that may contain both a traditional programming component and a shopping service.[14]

5. Several parties, in response to petitions for reconsideration, have urged the Commission to retain the offset requirement for home shopping revenues. The Arts and Entertainment Network favors retention of the offset requirement. It argues that direct cash payments to operators in the form of commissions encourage operators to base programming choices on financial incentives offered by home shopping services rather than on the quality of a channel's programming.[15] Lifetime TV argues that the offset requirement is needed to enable non-shopping networks to compete for limited channel space on cable systems. According to Lifetime, traditional program networks cannot match the economic incentives of home shopping channels if carriage of such channels allows recovery of both a channel adjustment mark up and unrestricted revenue from sales commissions.[16] With respect to advertising availabilities, a number of respondents challenge the petitioners' view that the absence of an offset for advertising availabilities discriminates against home shopping channels. Respondents argue that local advertising availabilities differ from commissions because they do not involve direct cash compensation and require operators to incur costs to produce advertisements and to acquire equipment necessary to air them.[17] In addition, ESPN claims that home shopping channels are not disadvantaged in comparison to traditional programmers because home shopping channels can also provide advertising availabilities to

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[12] HSN Petition at 7; Jones Infomercial Network Petition at 3.

[13] BET Response to Petitions for Reconsideration at 6.

[14] *Id.* at 3-4.

[15] Letter from Arts &Entertainment Network to Chief, Cable Services Bureau (March 15, 1995). For similar reasons, Tredyffrin Township, PA requests that operators be prohibited from recovering the per channel adjustment factor when adding home shopping channels. Letter from Tredyffrin Township to Chief, Cable Services Bureau (February 27, 1995).

[16] Letter from Lifetime Television Network to Chief, Cable Services Bureau (March 10, 1995).

[17] Letter from ESPN to Chief, Cable Services Bureau (March 24, 1995); Lifetime Television Letter at 2.

local operators.[18] Finally, the City of St. Joseph and Benton Charter Township (West Michigan Communities), in a petition for reconsideration, urge application of the revenue offset as a tier-based adjustment rather than an adjustment on a channel-by-channel basis.[19] In response to the West Michigan Communities Petition, QVC and Time Warner argue that governing statutes do not require tier-based offsets and that Commission rules properly apply the offsets on a channel-by-channel basis.[20]

C. Discussion

6. Based on the petitions for reconsideration and other comments in the record, we have determined that requiring operators to offset the mark up with home shopping sales commissions creates a disincentive for operators to carry home shopping services. Accordingly, in this Order, we eliminate this requirement.

7. We agree with petitioners that requiring operators to offset the per channel mark up with home shopping sales commissions creates a disincentive for operators to add home shopping services. As we explained in the *Going Forward Order,* the twenty-cent per channel operator mark up falls within the historical range of rate increases imposed by operators who add new channels and adjust their rates accordingly in competitive environments.[21] The allowance of this mark up is independent of the type of programming or the program licensing fee associated with adding the channel. Requiring operators to offset this mark up with revenues derived from sales commissions effectively eliminates the mark up in any case where commission revenues exceed program costs to the operator (usually zero in the case of home shopping channels) and the otherwise allowable mark up. Although we presume that cash payments to the operator in the form of commissions represent significant value to the operator, the partial or complete elimination of the mark up for adding a home shopping channel is a disincentive for an operator to add such a service. At the same time, we recognize that other programming networks may offer local advertising availabilities to operators for carriage of their services without putting the mark up at risk. By reducing or eliminating the operator mark up when home shopping channels raise sales commission revenue for operators, the offset requirement effectively penalizes the operator, and home shopping channels indirectly, by taking away the mark up simply because many customers in the operator's territory purchase products from the home shopping service. Consequently, the offset requirement has the effect of disfavoring carriage of home shopping services while favoring the carriage of traditional programming services that can provide

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[18] ESPN Letter at 2.

[19] West Michigan Communities Petition at 5-6.

[20] Time Warner Response at 12; QVC Opposition to Petition at 3. *See also* National Cable Television Association Opposition at 8; HSN Opposition at 7.

[21] *Going Forward Order,* 10 FCC Rcd. at 1252.

incentives to operators in the form of advertising availabilities not subject to the revenue offset rule.

8. As indicated above, some commenters argue that the Commission does not have to treat offsets against sales commission revenues and advertising availabilities in the same way to promote neutral incentives to add channels. For example, it has been argued that availabilities are different because operators may incur production and equipment costs when utilizing the availabilities.[22] Although advertising availabilities may entail some production costs, as suggested by ESPN and Lifetime Television, we believe that operators, as a general matter, limit their utilization of availabilities to instances where the net gain from such use exceeds the associated costs. Therefore, we do not think commissions are so different from availabilities to warrant granting different offset treatment. Finally, we are unpersuaded by suggestions that, because home shopping services theoretically could offer advertising availabilities, exempting the value of advertising availabilities from the offset requirement does not provide a comparative advantage to traditional networks. Generally, home shopping channels, unlike traditional program networks, are not developed or designed to attract commercial advertisers to air advertising time as is traditionally the case with other programmers. Consequently, advertising availabilities do not appear to be a viable alternative for home shopping channels. Exempting the revenue offset requirement for advertising availabilities creates an inherent disparity between home shopping services and channels that have been developed with the objective of becoming attractive advertising vehicles.

9. The offset requirement for home shopping sales commissions also creates administrative and practical difficulties. Although the channel adjustment factor remains available to the operator if revenues from an added shopping service fail to match the twenty-cent markup, the operator is still obligated to incur accounting costs and burdens, and some degree of regulatory scrutiny, to ensure compliance with the revenue offset rule. This burden may be sufficient to discourage an operator from adding to the CPST an innovative shopping service or a hybrid channel containing both traditional programming and shopping services. As a regulatory matter, the revenues derived from sales commissions can vary with each reporting period which renders difficult the incorporation of these fluctuations into the ratemaking process. Indeed, the Commission has not applied the offset requirement to advertising availabilities in part because of similar administrative burdens. Recently, the Court of Appeals upheld as reasonable the Commission's decision to forgo an offset requirement for advertising revenues.[23]

10. We recognize respondents' concerns that allowing operators the ability to

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[22] Letter from ESPN to Chief, Cable Services Bureau (March 24, 1995).

[23] *See Time Warner Entertainment Co. v. FCC*, No. 93-1723, slip op. at 22 (D.C. Cir.)(June 6, 1995).

recover the twenty-cent mark up regardless of the success of an added shopping service enhances the economic attractiveness of adding such channels. We reaffirm our belief, however, that Commission regulations should not influence the operator's decision for or against such services by making standard cost recovery available for carriage of one type of program service but not another. The decision to add a shopping service or a traditional programming service should be left to the operator's business judgment. Similarly, we will not discourage "traditional" services from adding a shopping component or providing advertising availabilities, with concomitant revenue incentives for operators, to their program offerings. By eliminating the revenue offset requirement as it applies to the operator's mark up, we neutralize availability of the mark up as a factor in the operator's decision to determine what kinds of program services should be added to the CPST.

11. This Order does not affect our requirement that revenue from shopping commissions must be applied as an offset against program costs.[24] We remain concerned that a programmer's definition of program cost can be manipulated to raise such costs artificially. Accordingly, we limit the scope of this Order to the revenue offset requirement for home shopping sales commissions as it applies to the per channel mark up only.[25]

III. Regulatory Flexibility Act Analysis

12. Pursuant to the Regulatory Flexibility Act of 1980, 5 U.S.C. §§ 601-12, the Commission's final analysis with respect to the Twelfth Order on Reconsideration is as follows:

13. Need for and purpose of this action. The Commission, in compliance with § 3 of the Cable Television Consumer Protection and Competition Act of 1992, 47 U.S.C. § 543 (1992), pertaining to rate regulation, adopts revised rules intended to ensure that cable services are offered at reasonable rates with minimum regulatory and administrative burdens on cable entities.

14. Summary of issues raised by the public in response to the Initial Regulatory Flexibility Analysis. Comments were filed in response to the Initial Regulatory Flexibility Analysis. HSN and Jones Informercial Network explain that operators face significantly less

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[24] The Cable Services Bureau previously clarified that "where a single cable channel is shared by different program services, the channel-by-channel standard for offsetting may be applied on a programmer-specific basis." This clarification is unaffected by this Order. See Letter from Chief, Cable Services Bureau to Black Entertainment Television, Inc. (December 19, 1994).

[25] Because we eliminate the offset rule as it applies to revenue from home shopping sales commissions, the Petition of West Michigan Communities, which requests application of the offset on a tier basis, is denied.

complexity when deciding to carry traditional advertiser-supported channels rather than home shopping services. They argue that advertising availabilities represent value to operators and that such value, unlike shopping commission revenue, need not be offset against the channel adjustment mark up, rendering less burdensome the addition of non-shopping channels.[26]

15. Significant alternatives considered and rejected. In the course of this proceeding, home shopping channels and other programming entities submitted requests to delete shopping commission revenue from the offset rule. This was the only proposal advanced by petitioners and the only alternative to current rules considered in connection with this specific action. In this Order, the Commission is providing relief to certain programmers seeking the elimination of regulatory burdens associated with the carriage of their channels.

IV. Paperwork Reduction Act

16. The requirements adopted herein have been analyzed with respect to the Paperwork Reduction Act of 1980 and have been found to impose new or modified information collection requirements on the public. Implementation of any new or modified requirement will be subject to approval by the Office of Management and Budget as prescribed by the Act.

V. Ordering Clauses

17. Accordingly, IT IS ORDERED that, pursuant to Sections 4(i), 4(j), 303(r), 612 and 623 of the Communications Act of 1934, as amended, 47 U.S.C. Sections 154(i), 154(j), 303(r), 532, 542(c) and 543, the rules, requirements and policies discussed in this Order ARE ADOPTED and Part 76 of the Commission's rules, 47 C.F.R. Part 76, IS AMENDED as set forth in Appendix A.

18. IT IS FURTHER ORDERED that the petitions for reconsideration filed by QVC, Inc. and Home Shopping Network, Inc. are granted consistent with this Order. The Petition for reconsideration filed by the West Michigan Communities is denied.

19. IT IS FURTHER ORDERED that the regulations established in this Order shall become effective 120 days after publication of this Order in the Federal Register.

FEDERAL COMMUNICATIONS COMMISSION

William F. Caton

William F. Caton
Acting Secretary

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[26] HSN Petition at 7-8; Jones Infomercial Network Petition at 3.

DISSENTING STATEMENT
OF
COMMISSIONER SUSAN NESS

Re: Reconsideration of Going Forward Rules: Home Shopping Offsets (MM Docket Nos. 92-266, 93-215)

This Order reverses the portion of the Commission's Going Forward Order adopted last November pertaining to the addition of home shopping channels to cable programming services tiers (CPSTs). I dissent from this reversal.

In the Going Forward Order, we established rules to provide incentives to cable operators to add new programming to regulated cable programming service tiers (CPSTs). We also sought to ensure that the incentives provided were neutral, encouraging operators to add programming based on factors such as quality and consumer demand, rather than any financial impact created by our regulation.

Under the going forward rules, an operator is entitled to raise subscribers' monthly rates up to 20 cents as a per-channel markup for each new channel added to the CPSTs. The rules also included an mark-up offset for home shopping channels. The offset was intended to eliminate the unfair advantage created by our rules if operators could both raise consumers' rates by the amount of the markup and be compensated in the form of sales commissions from carriage of home shopping channels. I believe that, rather than creating neutral incentives with this Order, we have reinstated this unfair advantage.

The arrangements between cable operators and home shopping channels are very different from the relationship between operators and entertainment-based programmers. Operators do not pay programming fees to home shopping channels as they do with other programmers; rather, the home shopping channels pay the operators in the form of sales commissions.

I am not persuaded that these sales commissions are comparable to local advertising avails offered by some programmers to operators. Operators receive regular, ongoing monetary payments of sales commissions directly from home shopping channels, requiring no investment on their part. Ad avails, to the extent they are made available to the operator, require a substantial investment of equipment and personnel on the part of the operator. The operator then receives ad revenues from advertisers, not the programmer, based on the operator's sales efforts. Home shopping programmers could, of course, offer ad avails in addition to, or in lieu of, sales commissions.

In my view, the mark-up offset for sales commissions was essential to our goal of providing neutral programming incentives. The offset ensures that an operator who

adds either a home shopping channel or an entertainment-based programming service is entitled to receive an incentive of at least 20 cents per channel, either through markup or through markup plus sales commissions. Our rules should not create incentives that favor the addition of one kind of programming over another. For that reason, I believe that our offset rule should be maintained.